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OF THE
ROYAL COMMISSION ON TAXATION

NUMBER 16

Specific Types of Personal Income



CANADA

S T U D I E S
of the
ROYAL COMMISSION ON TAXATION

Number 16

SPECIFIC TYPES OF PERSONAL INCOME

by

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Toronto

February 1967

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PREFACE


I should like to acknowledge with gratitude the assistance, in the preparation of this study, of Anton Melnyk, who wrote Chapter 7; Mrs. Millie Goodman, who wrote Chapter 8; John G. Smith, who prepared the memorandum on the tax treatment of expense allowances of Members of Parliament in Chapter 3; and the statistical staff, who compiled the statistics in Chapter 4.

This study was completed in July 1964 and was revised in November 1965 to reflect recent judicial decisions and changes in the legislation, and speaks generally as of the latter date, although a few later cases have been incorporated.

Douglas J. Sherbaniuk

Toronto

February 1967



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CHAPTER 1

WAGES AND SALARIES

INTRODUCTION

The bulk of personal income in Canada is made up of salary and wages, 1/ which have been subject to the federal income tax since its inception in 1917. Under the Income War Tax Act, 2/ "income" was defined in section 3 as including "...the annual net profit or gain or gratuity, whether ascertained and capable of computation as being wages, salary, or other fixed amount...." The words "wages" and "salary" were not defined. The present Income Tax Act 3/ provides in section 5:

Income...from an office or employment is the salary, wages and other remuneration, including gratuities, received by the taxpayer in the year....

Section 139(1)(ak), which defines "salary or wages", provides expressly that the definition does not apply to those words as used in section 5, 4/ where they would appear to have the common, ordinary meaning that the man in the street would ascribe to them. The Shorter Oxford English Dictionary (Third Ed. 1959) defines "salary" as "Fixed payment made periodically to a person as compensation for regular work"; the word "wages" is defined as "A payment to a person for service rendered; now esp. the amount paid periodically for the labour or service of a workman or servant".

METHOD OF TAXATIONHistory

The government's need for revenue to defray its expenditures remains fairly constant throughout each year and does not simply arise annually in March and April, when the bulk of personal income tax returns are filed. The government is able to collect a large portion of tax on salary and wages at an earlier date and on a more even basis through the deduction-at-source provisions contained in section 47(1), which impose an obligation on persons making certain enumerated payments, including "salary or wages or other remuneration to an officer or employee", to withhold from each such payment an amount prescribed by regulation and to remit it to the Receiver General of Canada on account of the income tax liability of the payee. Any portion of the income tax that is still owing when income tax returns are required to be filed for the year must be paid at the time of filing.

The system of withholding income tax at the source on salaries and wages came into being in 1942, at a time when the Department of National Revenue was flooded with work, suffered from a staff shortage and was confronted with the problem of coping with the consequences of wartime changes in taxation, such as higher rates and changes in the concept of the purpose of taxation, all of which made the law more complicated. "These changed circumstances", said the Deputy Minister of National Revenue, "called for drastic changes in the organization of the Taxation Division. Machinery and procedures which had been suitable during the pre-war era were in many instances wholly unsuitable to cope with the new conditions. Some of the problems were dealt with during the war period—for example,

the pay-as-you-earn plan of collection was introduced in 1942". 5/ The purpose of the withholding mechanism was explained by the then Minister of Finance, the Honourable J. L. Ilesley, in his Budget address:

With the higher rates now being put into effect, including the refundable portion of the tax, it is obvious that the income tax is something for which almost everyone subject to it must budget the year round. From the national point of view, it is necessary that these higher rates should be reflected in reduced spending power as soon as reasonably possible, and regularly thereafter rather than in fits and starts. Consequently it is proposed to commence in September of this year to deduct at the source as much as is practicable of the new income tax rates, including the refundable portion. 6/

The Meaning of "Salary or Wages or Other Remuneration" from
an Office or Employment for Tax Deduction Purposes

Section 139(1)(ab) defines the word "office" to mean "the position of an individual entitling him to a fixed or ascertainable stipend or remuneration..." and includes judicial, public and political offices and the position of a corporation director. "Employment" is defined by section 139(1)(m) to mean "the position of an individual in the service of some other person (including Her Majesty or a foreign state or sovereign)...." In the opinion of one commentator, "The essence of this definition is the fact that an individual is in the service of some other person, meaning, apparently, that the individual is under that person's direction or control in the performance of his duties". 7/ The definition also implies that there must be a contract of service establishing a relation between them in addition to the element of control.

The expression "salary or wages" is broadly defined in section 139(1)(ak) as follows:

(ak) "salary or wages", except in section 5 and paragraph (j) of this subsection, means the income of a taxpayer from an office or employment as computed under section 5 and includes all fees received for services not rendered in the course of the taxpayer's business but does not include superannuation or pension benefits or retiring allowances.

Thus, the "salary or wages" from which tax is deductible at source under section 47(1) includes not only salary or wages as those terms are commonly understood (see the dictionary definitions, supra), but also all remuneration for services rendered, such as bonuses, gratuities and honoraria; the value of free board and lodging and other benefits of any kind whatsoever (except for those benefits exempted in section 5(1)(a)), such as the use of the employer's car or yacht; and taxable allowances, with certain exceptions. Income from an office or employment would also appear to include payments falling within section 25, which is concerned with payments made to an officer or employee by an employer in consideration for accepting the office or entering into the employment or for a covenant by the officer or employee that he will or will not do certain things either before or after the termination of his employment. The above definition of "salary or wages" also includes fees for services not rendered in the course of the business of the recipient—for example, fees paid to a director—but would not include fees earned by a professional man, from which tax need not be withheld by the payer. Explicitly excluded from the definition are superannuation or pension benefits as defined in section 139(1)(ar) and retiring allowances as defined in section 139(1)(aj).

Obligations of the Employer

Under section 47(1), tax must be withheld by the payer of certain enumerated types of payments which relate to the rendering of services, including "salary or wages or other remuneration to an officer or employee". The employer is required to deduct tax from each payment of salary or wages in accordance with withholding tables prescribed in the Regulations, keep the amount of tax separate and apart from his own

monies 8/—for he is deemed to hold it in trust for Her Majesty 9/—and remit it to the Receiver General of Canada by the 15th day of the month following the month in which the remuneration was paid. 10/ Failure to comply with these requirements results in stringent penalties. More particularly, an employer who fails to deduct tax that should have been deducted is liable to pay a penalty of 10 per cent of the amount that should have been deducted, plus interest at 10 per cent per annum on the penalty. 11/ An employer who fails to remit tax withheld is liable to a penalty of 10 per cent of that amount, minimum \$10, plus the amount itself, plus interest on the amount at the rate of 10 per cent per annum. 12/ Moreover, an employer who fails to deduct, keep separate or remit tax that has been deducted, may be prosecuted and, if convicted, will be fined not less than \$200 or more than \$10,000 or may be fined and imprisoned. These severe penalties are necessary to assure a high rate of compliance by employers.

Each employer is also required to file a return in prescribed form with the District Taxation Office setting out the amount of tax withheld from salary and wages paid to officers and employees, and to forward to each employee by the end of February in respect of the preceding calendar year a statement in duplicate (T4) with respect to tax deductions from salary and wages. 13/

Obligations of Employees

The apparent aim of the deduction-at-source concept is to collect current taxes only in approximation of what the employee would have had to pay under the former system, on a reckoning made after the end of the calendar year. The personal exemptions of the employee must be known to

the employer to enable him to compute the amount of tax to be withheld under the tables. Every employee is required to file with his employer, on the commencement of his employment, the prescribed form TD1, certifying to the amount of personal exemptions claimed. 14/ Where the employee fails to complete form TD1, the employer deducts tax as though the employee were a single person without dependants, entitled only to the minimum personal exemption of \$1,000. 15/

In the event of a change in circumstances affecting the employee's personal exemptions, Regulation 107 provides in part that "...a new return shall be filed within 7 days of the date on which a change occurs in the deductions to which the employee is entitled under section 26 of the Act". Failure to do so can cause the employee to be liable to a penalty of \$10 per day for each day of default up to a total penalty of \$2,500. 16/ Apparently it matters not whether the change in circumstances increases or reduces his exemption. There is obviously good reason for requiring a new form to be filed where the taxpayer's exemptions are reduced, as where his wife, whom he has been claiming as an exemption, becomes employed and herself claims a basic exemption of \$1,000. But when an employee marries, there seems to be no valid reason why he should be required immediately to claim an exemption of \$2,000 under pain of severe penalty for failure to do so. The result of not claiming the additional exemption is that excessive tax is withheld and is not refunded until well after the end of the year. Indeed, he may choose to use the tax withholding device as a means of saving, which is, apparently, a growing practice in New York State:

The State Tax Department is convinced that there is a growing tendency among taxpayers to use the income tax withholding system as a device for enforced savings.

The taxpayer achieves the savings by reporting to his employer fewer exemptions than those to which he is entitled.

When the taxpayer makes out his state return, he reports the actual number of his exemptions. This generally assures the taxpayer of a tidy refund that can be used for a vacation or some other special purpose.

Tax Commissioner Joseph H. Murphy said the position of the Department was to encourage the practice, particularly by those persons who might otherwise end up owing the state money.

...Mr. Gollman (Deputy Tax Commissioner) cited the practice as one of the reasons for an increase in the number and average size of refunds so far this year. 17/

Under Regulation 107, where a change occurs in a taxpayer's personal exemptions by reason of, say, the death of his wife or child, the seven-day period within which he must file a new return begins to run, not from the date of the death, but rather from midnight, December 31st of the year in which the death occurs, for the death will not have worked a change in the exemptions to which he is entitled for that year but only for subsequent years. This is the administrative practice of the Department of National Revenue.

If a person is the employee of more than one employer, he is entitled to file an exemption certificate with each of them claiming the same exemptions and does not exhaust his exemption rights with the first filing, or filing with any particular employer.

Amounts of Tax to Be Withheld at Source

The amounts of tax to be withheld from salary and wages by reason of section 47(1) are prescribed by Part I of the Income Tax Regulations and in the withholding tables specified therein. It may be noted here that the issuance of three sets of withholding tables—one for Quebec,

one for Manitoba and Saskatchewan and another for the rest of Canada and abroad—has been necessitated by the fact that provincial taxes, which, by agreement, are collected by the federal authorities for all provinces except Quebec, and for which credit is given against the federal tax, are not imposed at the same rates. The amount of tax to be deducted will vary depending on the province in which is located the employer's establishment to which the employee reports for work.

The amount of tax to be withheld is arrived at by an employer on the basis of tables promulgated under the Regulations. The tables are designed to take into account the amount of the remuneration, the employee's personal exemptions certified on form TDI, and the length of the pay period, the tables providing for payments made on a daily, weekly, monthly or other basis. By merely following down the proper exemption column to the line opposite the proper wage bracket, the employer is immediately provided with the proper amount of tax to be deducted.

The scheme underlying the tables contemplates the making of an approximation of what the employee's total tax on compensation from the particular employer for the taxable year will be. The amount of tax set out in the tables reflects the application of the basic federal rate, the appropriate provincial rate and the old age security tax to the amount paid during a given pay-roll period, on the hypothesis that the employee will receive the same remuneration during each such pay-roll period throughout the year, and that his exemptions will remain static for the year. Thus, an employee hired at the rate of \$1,000 per month for a period of six months would have deducted from his monthly cheque the same amount of tax as would be withheld from the monthly cheque of an employee hired for a period of twelve months at \$1,000 per month, their exemptions being equal.

However, an employee's income may vary from one pay-roll period to another because of interruptions in his employment attributable to a variety of causes, such as sickness, strikes, involuntary unemployment, seasonal employment, and so on. Moreover, his exemptions may change during the year. Hence, his tax status as determined on a review at the end of his taxable year may well leave his tax liability either underpaid or, more likely, overpaid. If the taxpayer has other income, or if the tax withheld on his employment income has been insufficient, any remainder of tax is to be paid by April 30th of the following year. If excessive tax has been withheld, the remedy of the employee is to file a tax return showing the amount of the overpayment. Under section 57(1)(a), the Minister, where an assessment shows that tax has been overpaid, may send a refund with the notice of assessment and without any prior application therefor by the taxpayer. It is the practice of the Department to proceed in this way. If the Minister does not send a refund with the notice of assessment the taxpayer may, under section 57(1)(b), make written application to the Minister within four years from the end of the year for which the overpayment has been made. If this is done, the Minister will be obliged to make a refund of any overpayment. Even if an employer erroneously over withholds tax, the employee is obliged to wait until after the end of the year for his refund. He has no remedy against the employer, for as long as the employer withholds tax "in compliance or intended compliance with this Act" no action lies against him. 18/ Nor is there any authority in the Act or Regulations for an employer to make an adjustment in a subsequent period to compensate for a prior excessive erroneous withholding, although if the employer voluntarily chooses to do so, the Department does not, in practice, object.

Special provisions are contained in the Regulations in respect of (1) bonuses and retroactive pay increases; (2) payments out of pension funds and other similar payments which may be averaged under section 36; and (3) payments out of profit sharing plans or revoked plans under section 79C.

THE UNITED KINGDOM SYSTEM OF WITHHOLDING TAXES
ON EMOLUMENTS FROM AN OFFICE OR EMPLOYMENT

In the United Kingdom, income tax on emoluments from an office or employment is withheld at source under the pay-as-you-earn system (P.A.Y.E.), which was introduced in 1943 in response to the need to ensure that tax imposed at high wartime rates was paid by regular instalments over an extended period. The modus operandi is governed by regulations and tables pursuant to which an employer must deduct the tax payable in respect of all emoluments and account for and pay such deductions to the Revenue once a month. If he fails to deduct tax, or sufficient tax, he remains liable to the Revenue who may also, in certain cases, proceed against the employee.

The British collection machinery is more sophisticated than its Canadian and United States counterparts, and is distinguished by its cumulative nature. That is to say, the amount of tax deducted from each payment keeps in step with the employee's income, so that the total tax borne at any date in the year is related to the total pay to date.

In the words of one commentator,

Under a cumulative system, the wages received in a particular week or month are added to the total of wages previously accumulated in the elapsed portion of the tax year. An individual's tax-free allotment, reflecting his allowable exemptions and deductions, is apportioned evenly throughout the year. On any given date, taxable income is established by subtracting the accumulated tax-free allotment from total wages. The tax withdrawn on a particular date consists of the difference between the tax due on total taxable income as of that date and the sum of previous tax withdrawals made during the year. 19/

The amount of tax that has been withheld by the end of the year is made to approximate quite closely the total tax due for the year on the employee's earnings, despite substantial variations in the amounts paid to the employee in the course of the year, spells of unemployment, absence due to illness, changes in employment, alterations in the reliefs or exemptions to which he is entitled and so on. Modifications of the system are required to deal with cases where the taxpayer has more than one employment, or engages in casual employment, so that deduction by use of the Tax Table is impracticable.

A unique and important feature of the P.A.Y.E. system is that if there has been any overwithholding of tax, the employer must make the necessary refund to the employee and adjust his account with the Revenue. Over-deduction of tax may result where a sudden drop in earnings occurs, or where an instalment in pay is small in comparison to the average amount of previous instalments for the current year. Thus, an employee may receive successive repayments of tax each week until previous tax payments are exhausted. "In this sense, P.A.Y.E. carries built-in unemployment compensation". 20/ Indeed, so accurately does the P.A.Y.E. system function that a large proportion of wage earners—estimated as high as 4/5ths—21/ need file no income tax return at all, and assessments are dispensed with. To this extent, the administrative burden on the Revenue officials is eased.

The following lucid exposition of the operation of P.A.Y.E. appears in the Second Report of the Royal Commission on the Taxation of Profit and Income: 22/

PRACTICAL WORKING OF THE SYSTEM

16. Under any scheme which utilises a current earnings basis a man's employer must be instructed as to the amount of weekly pay which is effectively free from tax by the operation of the man's personal allowances, etc. For this purpose, as has been stated, code numbers are used. Under a cumulative system the employer must also be enabled to make a ready comparison between the tax already suffered and the total tax for which the employee will be liable when the current payment of wages has been effected, the difference being the amount of tax to be deducted from that current payment. For this purpose, the tax office will provide him with a record card on which weekly entries of pay and tax can be made. Finally, the tax tables show the employer the amount of tax corresponding to any figure of pay on which liability arises after the employee's free pay has been taken into account. To illustrate the working of the system we now take an example to show how tax deductions vary according to changes in the weekly level of remuneration and in the employee's circumstances.

17. The coding process is that before the beginning of the tax year (which we have taken as the year 1953-54) the tax office ascertains the personal allowances expected to be due to the employee for the coming year. Suppose he is a married man with one child, is entitled to an allowance of £10 for life insurance premiums in addition to the usual allowance for national insurance contributions, and has an estimated £9 of untaxed income apart from his earnings (e.g., savings bank interest). Out of the allowances due to him, £9 is reserved to wipe out liability on the other income; the remaining allowances, totalling £305, are available to be set against the employee's pay. A "notice of coding" showing the allowances and the corresponding "code number" (98 in this instance) is then issued to the employee, unless the code number is the same as for the previous year; the earned income relief and reduced rate relief are given automatically by the tax tables and do not appear on the notice. The next step, subject to the settlement of any objection or appeal against the coding, is to issue to the employer a tax deduction card on which the employer will keep a weekly record of the pay and tax deductions. The employer is also sent a set of tax tables.

18. The employee's pay for Week 1 is £10. The employer enters this figure on the card and then finds in Table A for Week 1 the "free pay" for code 98; this is £7 12s., which is the weekly equivalent of allowances of £305, plus the appropriate earned income relief. The excess of the actual pay over the free pay is the "taxable pay". In this instance it amounts to £2 8s. The employer then looks up in Table B the tax due on taxable pay of this amount, which he finds to be 4s., and this is the amount of tax to be deducted in Week 1.

19. In Week 2 the pay is £11 5s., giving total pay to date of £21 5s. The free pay to date is ascertained from Table A for Week 2 to be £15 4s. This gives total taxable pay to date of £6 1s. Table B

for Week 2 shows that the "total tax due to date" on "total taxable pay to date" of this amount is 13s.; as 4s. was deducted in Week 1, the difference, 9s., is the amount to be deducted in Week 2.

20. The process is repeated in each subsequent week and by Week 5 tax of £1 10s. has been deducted in respect of total pay to date of £52. In Week 6, however, the employee's pay falls off to £3 (whether because he was sick, or took a few days off, or for whatever reason) and, on going through the process described above, the employer finds that the total tax due, viz., 17s., is less than the tax deducted over the first five weeks. Accordingly, not only is there no tax to be deducted in Week 6, but the difference of 13s. is repaid to the employee with his week's wages.

21. Some time later the employee's wife has a second child. He applies to the tax office for a revised code number, which (after reserving a part of the new child allowance to cover tax on the 8s. a week family allowance) is found to be 117 (corresponding to allowances of £379 for set-off against pay). The employer is notified of the new code number in time to use it in Week 15. Tax of £4 6s. has been deducted down to Week 14 in respect of total pay of £146, but on applying the new code of 117 to the total pay, £156, to the end of Week 15, the employer finds that the new figure of tax due to date is £1 7s. Instead of deducting tax he therefore repays the employee £2 19s.

22. Though we have so far considered continuous employment under one employer, the system applies the same cumulative principle when the taxpayer moves from one job to another during the tax year. It is the duty of the old employer to furnish him with a leaving certificate recording his current code number and his total pay and tax to the date of leaving. When this is presented to the new employer it puts him at once in a position to make deductions from the pay in the new employment on a basis which keeps them in line with his total earnings so far during the year.

23. A taxpayer may, however, give up one job without taking on any other before the end of the year. In the example used above the employee had a net amount of £1 7s. tax deducted up to the end of Week 15: suppose that his earnings cease at this point. Nevertheless he remains entitled each week to a further 1/52nd of his allowances and as there is no pay in the subsequent weeks to absorb the further allowances which become available, the cumulative principle requires that these allowances should be carried back and set against the earnings of Weeks 1-15. The employee will thus be entitled to gradual repayment of the tax already deducted. In principle, a further repayment arises each week until either the tax deducted in Weeks 1-15 has been repaid or the end of the tax year arrives. In the example taken the whole of the tax deducted would be repaid in two weeks, assuming weekly repayments (as to the actual procedure, see paragraph 26 below). If the earnings had ceased later in the year the repayments might continue until the end of the year; at this point they would cease and no further repayment would be due,

for the total net tax deducted over the whole year would be the tax appropriate to the actual earnings of the year, notwithstanding that over the latter part of the year the employee had received no pay.

THE UNITED STATES SYSTEM OF WITHHOLDING
INCOME TAX ON SALARY AND WAGES

The United States system of withholding income tax on salary and wages, introduced in 1943, is roughly similar to the Canadian mechanism described above. An employer is required to withhold the specified tax from each payment of wages or salary to an employee, except payments to agricultural and domestic workers, persons not regularly employed in the course of the employer's trade or business, and a few other groups. The "wages and salaries" subject to withholding are construed in the broadest manner to include all remuneration for services, including such items as the value of meals and lodging furnished by an employer to an employee, pensions and retirement pay, travelling and other allowances, dismissal payments, and so on.

An employee is required to supply a withholding exemption certificate to his employer, setting out the number of exemptions to which he is entitled. The employee is expressly permitted to give his employer his reasonable expectation as to dependants for whom he will be entitled to credit at the end of his taxable year, and the employer is authorized to rely upon this statement in making withholdings, unless otherwise advised. The employee can also claim an additional withholding exemption for expectant attainment of age 65 within the taxable year, probable blindness, or both. Changes in withholding exemptions which affect the calendar year and require the filing of a new certificate by the employee may occur by reason of such circumstances as where the employee's spouse for whom he was

claiming an exemption claims her own withholding exemption on a separate certificate. December 1st of each year is made a sort of deadline for consideration of withholding exemptions for the next year, and by that date employers are supposed to bring the subject to the attention of their employees.

The employer computes, either by a formula or by reference to tables prescribed by statute, the amount to be withheld at each pay period from the employee's wages. The tables provide for daily, weekly, biweekly, and other pay periods, and are based on an 18 per cent rate applied to the amount earned, less the employee's prorated annual personal exemptions (for himself, his wife and dependants) and a prorated flat allowance for deductions. The employer is required to turn over the amounts withheld to a designated Federal Reserve Bank monthly and to file with the District Director of Internal Revenue a quarterly return with respect thereto. On or before January 31st of the year following the year for which the tax was withheld or on termination of the employment, the employer must furnish each employee with a statement showing his total earnings and the total amount of tax withheld. A duplicate of this statement must be filed with the Treasury, where it serves as an information return to ensure compliance by the employee, who attaches his copy to his tax return, which he files by April 15th. The amount withheld is credited on his actual liability, and he either pays the balance due or receives a refund if there was overpayment.

If an employer makes excessive or inadequate withholdings, the error can usually be adjusted between him and the employee if discovered before the employer makes his withholding return. If not discovered until after such return is made, the matter can be adjusted by amending the withholding

return and making appropriate accounting entries. The Regulations look to quarterly adjustments of this nature.

EFFECTS OF DEDUCTION OF TAX AT SOURCE

On Tax Administration and Revenue Collection

The deduction-at-source system of collection of income tax on wages and salaries is now regarded as a major advance in tax administration. It has proved to be a highly successful and efficient method of collecting vast amounts of revenue with a minimum of difficulty, ensuring high tax compliance and bringing funds into the Revenue at an early date.

The withholding system was introduced in Canada at a time when the Taxation Division found itself caught between a tremendously increased workload—the number of personal income taxpayers advanced from 293,000 in 1938 to 1,781,000 in 1942, 23/—and the impossibility of recruiting additional suitable staff. The need for the withholding mechanism remains undiminished, for the number of personal income taxpayers has continued to increase—in 1962, it was estimated at 4,615,000, 24/—and the problem of recruiting and retaining staff persists. 25/ The deduction-at-source concept as an aid to administration was lauded by a United States revenue officer as follows:

During fiscal 1958, 7 out of every 10 personal income tax dollars collected were withheld from wages and salaries by employers. As a result, the tax collection workload has been reduced to manageable proportions and, instead of millions of potentially delinquent accounts, we annually refund about 4 billion dollars of overwithheld tax to about 35 million taxpayers. 26/

The tax withholding system on wages and salaries has resulted in a high degree of tax compliance. In the opinion of one United States tax

administrator, "There is little question that income tax withholding on wages and salaries is responsible for the relatively small amount of under-reporting of this type of income, which has been estimated at less than 5 per cent of the gross wage and salary income reportable". 27/ The reporting of salary and wages in Canada has been estimated to be equally effective. 28/

While certain disadvantages may inhere in the collection-at-source concept—the bother and expense to employers, for example—to tax administrators it is surely a pearl of great price and is justifiably embedded in the Canadian tax system as an indispensable aid to tax collection. As a former Commissioner of Internal Revenue succinctly put the matter, "Frankly, I do not see how we could possibly hope to collect the revenue we need if compulsory withholding were abolished". 29/ In a more critical vein, a Canadian commentator has acknowledged the effectiveness of the tax withholding system:

If the pre-war method of income tax collection were still in force I believe that the present rates of tax would be uncollectible. The problem would be not that of determining income but of collecting the tax payment when due. Today's heavy rates (minimum 15 per cent) and low exemptions are practicable only because the tax is now deducted at the source. Withholding at the source, the most refined form of which is the pay-as-you-earn system, is a method which combines the expedient and the objectionable. It is a rough and ready system which virtually garnishees taxpayers' incomes, sometimes for debts they do not owe but subject in this event to refund. It is surprising that this withholding system, to which strong objections may be raised on grounds of principle, has aroused so little comment. It has probably done more to increase the tax-collecting power of central governments than any other one tax measure at any time in history. 30/

On Employers

The experience of the Department of National Revenue with employers in their role as involuntary tax collectors with respect to the expected tax obligations of their employees has proved to be a relatively happy one:

Some 210,000 employers throughout Canada conscientiously make tax deductions from their employees and forward it to the Division. A very small number requires watching. If their finances get shaky, there is a temptation to appropriate the trust funds they have withheld as income tax from their employees. We watch for these cases by following the activity of their tax deduction accounts on our records, by comparison with other information available and by sending in payroll auditors where warranted. 31/

Thus, employers have accepted the burden not only of bother and inconvenience, but of considerable expense as well. A recent study by the Canadian Tax Foundation states:

The average cost of collecting taxes [personal income taxes, non-resident taxes, hospital insurance premiums and commodity taxes imposed at the retail level] came to about \$16,000 a year. This was a trifle over one-half of one per cent of total taxes collected by the companies....

The work of making personal income tax deductions at the source cost the companies an average of nearly \$8,400 a year—or about one-half of their total costs of acting as a collection agent for governments. 32/

And further:

Companies with over 5,000 employees spent an average of \$25,000 on income tax work. Those with 1,001 to 5,000 employees spent nearly \$7,500, those with 400 to 1,000 employees spent \$2,900 and the smallest companies averaged about \$1,200 per year. As with the other taxes, the companies differed widely in their experience. The range of costs for collecting personal income taxes ran from a high of \$102,771 to a low of \$100.... Since companies operating in Quebec have the added complication of withholding provincial income taxes, one would expect their costs to be higher than the... averages. A separate analysis was made of companies which gave Quebec as the location of their head office, and it showed that their average costs for personal income tax work were \$13,000 a year—nearly \$5,000 higher than the average for all companies. 33/

Since the withholding mechanism functions only with employer co-operation, tax administrators must remain sensitive to the weight of the burden they place on employers, lest it grow so heavy as to alienate them and impair compliance. This factor must be borne in mind when changes in the tax deduction system are considered.

On Employees

The withholding-at-source system has the obvious merit of providing a convenient method for employees to budget for the disagreeable task of paying their taxes. Criticism, however, has been levied at this method of collecting taxes because of certain adverse effects it is alleged to have on employees, namely, (1) that it serves as a disincentive to hard work, and (2) that tax is over withheld too frequently. Each of these criticisms warrants inquiry.

DISINCENTIVE EFFECT

The argument was advanced before the United Kingdom Royal Commission on the Taxation of Profits and Income that the progressive character of the income tax, operating through the P.A.Y.E. system, was a deterrent to hard work and an obstacle to the introduction of incentive schemes because of the fact that the taxpayer's attention is so forcibly directed to the fact that his extra earnings attract higher tax than he pays on his average wages. If this criticism is valid for the P.A.Y.E. system, it is equally valid for the Canadian withholding system, for, as has already been noted, each pay period is treated in isolation, so that an employee is made immediately aware of the higher rate of tax on his extra earnings during a pay-roll period. With a view to determining the accuracy of this contention, the Royal Commission sponsored a study by the Social Survey, a government sociological research unit, and on the basis of the results of the study, reached the conclusion that the detrimental effects of P.A.Y.E. had been greatly exaggerated, and that P.A.Y.E. as a machine for collecting tax was sometimes blamed for defects which more probably were the result of the total weight of taxation.

The study demonstrated that "In the first place, P.A.Y.E. as a method of collecting tax was not unpopular. Secondly, the marginal tax rate seems to have little significance in affecting the behaviour of workers. Very few of them, it seems, have sufficient knowledge of the way they are affected by the tax to be able to take that factor accurately into account in deciding upon behaviour at work". 34/ However, a critic of both the Royal Commission report and the survey has stated that "While the average worker's understanding of P.A.Y.E. may not be great, he does know the difference between tax-free earnings and taxed earnings, and it is not uncommon to find workmen—particularly the single man—seeking additional evening and part-time work on condition that tax is not deducted from the income". 35/

OVER WITHHOLDING OF TAX

Under the Canadian system of withholding, excessive tax may be deducted at source in such circumstances as where, in the course of the year, the employee becomes entitled to additional exemptions, or suffers unemployment, or lower than average wages, or where the tax is over withheld in error. Both taxable and non-taxable persons—that is, those whose earnings do not exceed their exemptions—may be affected. For example, in 1961, of the 4.5 million individuals who paid income tax, 2.7 million, or almost 59 per cent received refunds. Of the 1.46 million non-taxable individuals who filed returns, .95 million, or 65 per cent received refunds. 36/ Of the total of 3.5 million individual taxpayers who received refunds amounting to 222.4 million dollars, 3.4 million had had tax deducted at source and received refunds of 197.3 million dollars, or 89 per cent of the total. 37/

Since over withholdings are not rectified until after the end of the taxation year, the deduction-at-source system may work hardship in certain cases, One commentator has said:

Over withholding penalizes the unemployed, the sick, and others who experience an involuntary interruption in employment. Students, housewives, and the like who work for limited periods only are compelled to postpone receipt of a part of their wage until the spring of the succeeding year. 38/

There would doubtless be more over withholdings in the case of non-taxable persons but for the provision in the Regulations authorizing the exclusion from deduction at source of those employees who certify that their total earnings will not exceed their exemptions. There are no statistics as to how many persons avail themselves of this relief; the provision would probably be more effective in minimizing over withholding if it were more forcefully brought to the attention of employees, as, for example, by having it printed in red ink on the TDI form.

Additional relief is available in cases where an employee's earnings may exceed his exemptions by a very small amount. In such cases relief may be had under Regulations 102(5) and 106. The former provides that, instead of deducting tax in accordance with the withholding tables, "...an employer may, with the approval of the Minister, make a deduction from each payment equal to that proportion of the payment that the tax on the estimated total annual remuneration of the employee, calculated at the prevailing rates, is of the estimated total annual remuneration". And under Regulation 106, "Where the Minister is satisfied that the amount otherwise to be deducted would constitute an undue hardship, he may determine the amount, if any, to be deducted". These provisions are effective only to the extent that employees are aware of them and request relief under them, or that employers choose to use them in appropriate cases. There are no statistics available to indicate the extent to which these regulations are used.

Of course, the adoption in Canada of the P.A.Y.E. type of sytem which the recent British Royal Commission lauded as having the "solid advantage that it keeps the taxpayer's liabilities in line with his current earnings" 39/ would obviate to a large extent the problem of over withholding. P.A.Y.E. also has the merit, as has already been noted, of providing built-in unemployment relief, in that a taxpayer becomes entitled, as the immediate result of a drop in his earnings, to repayment of tax previously paid. He can use the repayment of tax to aid in financing himself during periods when he is without work. A student of the P.A.Y.E. system has stated:

The proposal carries important counter-cyclical implications. The nearly 4 billions of overwithheld tax constitute a potential force for economic stability. The cumulative sytem would harness this force. The tax refunds that would be paid out to the unemployed in a period of general economic distress would not only provide a measure of relief to such persons, but would also bolster disposable income throughout the economy. A sharp increase in industrial lay-offs would trigger an increase in tax refunding activity. The carry forward embodied in cumulation would reduce tax withdrawals for the re-employed at a time when the economy was recovering from the depths of a recession. In contrast to the present system, cumulative withholding promises to maintain a higher level of disposable income throughout the depressed stages of the business cycle. Furthermore, the refunding operation would be pinpointed to the principal regions of unemployment. The application of either or both the carry-back and carry-forward of unused exemptions would serve to promote stability, no matter in what month of the year the trough of the cycle occurred.

It is difficult to quantify the potential counter-cyclical importance of cumulation....

The importance of tax refunds has been recognized in recent recessions. The Economic Report of the President issued in January 1954 urged the acceleration of annual tax refunds as a counter-cyclical measure. In both the recession years of 1958 and 1961, tax refunding was deliberately hastened as the conscious response to economic conditions. Cumulation will accomplish the required refunding with greater speed and efficiency. The system would satisfy the requirements laid down by those economists who have urged that tax refunds be made before the close of the calendar year. 40/

The vast bulk in both number and amount of refunds mailed to Canadian taxpayers is heavily concentrated in the months of March, April and May, as appears in the following table:

TABLE 1

MONTHLY REFUNDS IN 1962-63 OF TAX
WITHHELD ON SALARIES AND WAGES a/

<u>Month</u>	<u>No. of Taxpayers Receiving Refunds</u>	<u>Amount</u>	<u>No. of Unemployed in Canada <u>b/</u></u>
April 1962	785,129	\$48,129,098	457,000
May 1962	931,400	57,317,801	324,000
June 1962	338,113	26,838,889	290,000
July 1962	76,898	7,201,000	292,000
August 1962	23,632	2,213,606	263,000
September 1962	9,841	844,689	247,000
October 1962	10,627	869,905	267,000
November 1962	5,994	528,876	324,000
December 1962	4,635	390,041	387,000
January 1963	3,662	308,132	503,000
February 1963	84,324	5,556,054	512,000
March 1963	<u>976,990</u>	<u>67,376,608</u>	511,000
	<u>3,251,245</u>	<u>\$217,574,699</u>	

Source:

a/ Department of National Revenue

b/ Department of Labour

The almost immediate refunding of overpaid tax under the P.A.Y.E. system may not be an unmixed blessing. There is some slight evidence that in the United Kingdom the prompt repayment of overwithheld tax leads to absenteeism and is a possible incentive to idleness. According to evidence submitted by the National Coal Board to the Royal Commission, the allegation was not true that absenteeism was more prevalent in the closing months of the income tax year because larger repayments could be obtained then; however, the Board did go on to conclude:

Summing up, the Board share the views of the Divisional Boards that by throwing into relief the higher rate of tax payable upon the top slice of income, P.A.Y.E. probably tends to increase week-end absenteeism. The prospect of a tax refund probably encourages absence for a full week. Some miners may regulate their attendance by reference (among other factors) to income tax payments and refunds. These views remain, however, matters of opinion unsupported by factual evidence and responsibility may lie with the high rate of tax rather than with the P.A.Y.E. system itself. The conclusion which the Board draw from their investigations is that P.A.Y.E. is not a major cause of loss of coal output though it **probably** contributes to it. Public opinion has probably exaggerated its effect on output. 41/

The extent to which over withholding of tax on salaries and wages is a matter for serious concern is difficult to say. Few complaints about the withholding system have been received by the Department of National Revenue, and none of the submissions to the Canadian Royal Commission on Taxation has commented on the manner of taxing wages and salaries. According to one United States writer, "Actually, nontaxable wage earners do not seem to object to withholding, and it is doubtful whether quick refunds are needed...for them...." 42/ And further, "During the early days of the wage-withholding system, considerable concern was expressed by some people that wage earners would resent being overwithheld on. In fact, more than 30 million refund checks are mailed each year—yet few complaints have been received by the Internal Revenue Service". 43/ As was noted earlier, some

employees in the State of New York intentionally understate their exemptions with a view to using the withholding system as a means of enforced saving.

APPRAISAL

There is no doubt that salaries and wages, which have been taxed since the inception of federal income taxation in 1917, will continue to form the large bulk of personal income subject to tax, and that a personal income tax will continue to be a necessary part of our overall tax system.

There are, however, certain modifications and changes in the present withholding mechanism that Parliament might regard as worthy of consideration:

1. Require employers to forward T4 slips at an earlier date, say, by the end of January, as in the United States, rather than the end of February, so that returns could be filed and refunds made that much sooner. While this might place a slight additional burden on employers, it would serve the end of equity in that over withheld taxes would be earlier returned to taxpayers, many of whom would doubtless find themselves among the ranks of the unemployed, and would also boost the spending power during what is often a depressed stage of the business cycle by the earlier injection into the economy of large amounts of revenue.
2. Provide a means for the correction of errors in the amounts of tax withheld from employees. Such a provision would serve to remedy the gross inequity which arises when an employee is over withheld in error, and has no legal recourse but to await a refund well after the end of the year. Perhaps a system of quarterly adjustments would suffice.

3. Reduce and relieve over withholding by:
 - (a) Bringing more effectively to the attention of employees the existing relief provisions in Regulations 102(5), 104 and 106; and
 - (b) Providing for a system of intra-annual refunds, with appropriate safeguards for the Revenue.
4. Abandon the present withholding system in favour of the more sophisticated P.A.Y.E. system, which truly keeps an employee's tax liability in step with his earnings. Such a system would doubtless cast an increased administrative burden on both employers and the Department of National Revenue, and might well prove to be more expensive. On the other hand, a cumulative system such as P.A.Y.E. provides for more equitable treatment of employees, as compared with our present system, through a reduction in the volume of over withholdings, and also has certain important counter-cyclical implications. 44/

The P.A.Y.E. system was considered by the Department of National Revenue in 1942, and was rejected in favour of the present system, primarily because of the heavier administrative burden on employers.

REFERENCES

- 1/ According to statistics compiled by the Department of National Revenue, salary and wages made up 83 per cent of all personal income for the period 1957 to 1961, inclusive: Selected Tax Data 1963, pp. 28 and 67. In 1961, of a total of 19.6 billion dollars of personal income reported by individual taxpayers, 16.4 billion, or nearly 84 per cent, was made up of salary and wages: ibid., p. 67. A somewhat different result has been reached by the Dominion Bureau of Statistics, which reports that for the period 1957 to 1961, inclusive, wages and salary and supplementary labour income averaged only 66 per cent of total personal income. D.B.S., National Accounts Income and Expenditure, 1961, p. 17; Selected Tax Data, 1963, p. 28.
- 2/ S.C. 1917, Chapter 28.
- 3/ R.S.C. 1952, Chapter 148. All references in the study to sections are to the Income Tax Act, unless otherwise specifically designated.
- 4/ The words "salary" and "wages" appear in other sections of the Act, e.g., section 11(1)(ib) (deduction of legal expenses incurred to collect salary or wages); section 32(5) (definition of "earned income"); and section 47(1)(a) (withholding of tax from salary and wages).
- 5/ See C. Gavsie, "Tax Administrative Organization at the Federal Level", 2 Tax Bulletin (1952), 271 at p. 273.
- 6/ House of Commons Debates, 1942, vol. 4, p. 3584. The Canadian withholding system has remained substantially unaltered since its introduction.
- 7/ F. E. LaBrie, Introduction to Income Tax Law - Canada, Toronto: CCH Canadian Limited, 1955, p. 45.
- 8/ Section 123(5).
- 9/ Section 123(4).
- 10/ Regulation 108(1). As of November 1, 1964, employers may remit withheld taxes through the agency of the chartered banks. See the Notice to All Employers in the Canadian Tax Reporter, Toronto: CCH Canadian Limited, vol. 1, para. 13-083.
- 11/ Section 123(8).
- 12/ Section 123(9).
- 13/ Section 117(1)(e) and Regulation 200.
- 14/ Section 123(2) and Regulation 107.

- 15/ Section 123(3).
- 16/ Section 129(1).
- 17/ D. Dales, New York Times, May 19th, 1963, p. 45, col. 1.
- 18/ Section 123(1).
- 19/ Allen P. Murray, "A Proposal for Cumulative Withholding", 15 National Tax Journal (1962), 184.
- 20/ G.S.A. Wheatcroft, The Law of Income Tax, Surplus and Profits Tax, London: Sweet & Maxwell, Limited, 1962, p. 1093.
- 21/ Carl S. Shoup, "Tax Tension and the British Fiscal System", 14 National Tax Journal (1961), 1 at p. 36.
- 22/ Cmd. 9105, London: H.M.S.O., 1954, pp. 6-7.
- 23/ The National Finances, 1962-63, p. 29.
- 24/ Ibid., p. 29
- 25/ See H. H. Milburn, "Methods of Enforcing the Personal Income Tax", Report of the 12th Annual Tax Conference, Canadian Tax Foundation, 1958, 273 at p. 279.
- 26/ O. Gordon Delk, "Methods of Enforcing the Personal Income Tax", Report of the 12th Annual Tax Conference, Canadian Tax Foundation, 1958, 273 at p. 282.
- 27/ R. C. Harrington, "Improving Income Tax Reporting", 2 Tax Revision Compendium (1959), 1461 at p. 1464.
- 28/ Roger Carswell, "Methods of Enforcing the Personal Income Tax", Report of the 12th Annual Tax Conference, Canadian Tax Foundation, 1958, 273 at pp. 286-87.
- 29/ Dana Latham, "Income Tax Administration", Management's Stake in Tax Administration, Symposium conducted by the Tax Institute, 1960, Princeton: Tax Institute Incorporated, 1 at p. 4.
- 30/ D. C. MacGregor, "Further Thoughts on Tax Levels and Prospective Welfare Expenditures", 4 Canadian Tax Journal (1956), 171 at p. 173.
- 31/ D. H. Sheppard, "Tax Administration II, The Government's Problems", Report of the Tenth Annual Tax Conference, Canadian Tax Foundation, 1956, 238 at p. 261.
- 32/ Marion H. Bryden, Costs of Tax Compliance, Canadian Tax Foundation, 1961, p. 17.
- 33/ Ibid., p. 23.

- 34/ Royal Commission on the Taxation of Profits and Income, Second Report, Cmd. 9105, London: H.M.S.O., 1954, p. 14.
- 35/ A. R. Ilersic, "Personal Taxation—U.K.", 2 Canadian Tax Journal (1954), 220 at p. 222.
- 36/ Selected Tax Data, 1963, p. 65.
- 37/ Selected Tax Data, 1963, p. 36.
- 38/ Allen P. Murray, "A Proposal for Cumulative Withholding", 15 National Tax Journal (1962), 184 at p. 188.
- 39/ Royal Commission on the Taxation of Profits and Income, Second Report, supra, reference 34/, at p. 27.
- 40/ Allen P. Murray, "A Proposal for Cumulative Withholding", 15 National Tax Journal (1962), 184 at p. 189.
- 41/ Quoted in the Royal Commission on the Taxation of Profits and Income, Second Report, supra, reference 34/, at p. 13.
- 42/ J. A. Pechman, "Withholding for Interest and Dividends", 2 Tax Revision Compendium (1959), 1479 at p. 1494.
- 43/ Ibid., p. 1496.
- 44/ The advantages and disadvantages of P.A.Y.E are discussed by Allen P. Murray, "A Proposal for Cumulative Withholding", 15 National Tax Journal (1962), 184.

CHAPTER 2

TIPS

Tips have been held to be includible in income under the United Kingdom Income Tax Act 1/ and would appear to fall within the provisions of section 5(1) of the Canadian Income Tax Act, which states:

Income for a taxation year from an office or employment is the salary, wages and other remuneration, including gratuities, received by the taxpayer in the year.... [Emphasis added.] 2/

However, doubt on this point has been expressed as follows:

A question arises as to whether employment income must be "from" an office or employment in the sense of being payable under the contract creating the office or employment. Suppose that a third party makes a payment to the holder of an office or employment, e.g., the tips paid to the driver of a taxi-cab by his fares. The English case law would indicate that this amount is income since it is paid with a view to the service rendered and not out of personal regard for the recipient. These cases may serve to bring these payments within the general designation of income from all sources in sec. 3. But sec 5(1) may be open to a narrower construction. 3/

The major problem arising in connection with the taxation of tips and gratuities is the failure of the recipients to report them in their returns. It is understood that the Department of National Revenue acknowledges that a large proportion of income in the form of tips is probably unreported, and that it has not yet been able to work out a satisfactory solution to the problem. Any type of deduction at source could easily lead to inequities. A United States commentator, dealing with a similar problem in the United States, has proposed the following solution:

There is a large area...in which withholding on reporting by the payer is not feasible. Miscellaneous jobs performed in extra time, by persons whose principal income is from wages and salaries, undoubtedly total a very large sum for the whole country. Probably only a small percentage of this income is reported. The same may be said of tips. Perhaps the most effective program relating to these matters is one of continuing education as to what is taxable and what is expected of the taxpayer. At certain times of the year, for example, restaurants and hotels might be asked to post appropriate notices, in rooms accessible to employees. 4/

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- 1/ See Calvert v. Wainwright, 27 Tax Cas. (1947), 475.
- 2/ See Montaine v. M.N.R., 2 Tax A.B.C. (1950), 254; 50 DTC 342, where the Tax Appeal Board assumed that tips were income.
- 3/ Canada Income Tax Guide, Toronto: CCH Canadian Limited, para. 1230.
- 4/ S. Avakian, "Compliance and Enforcement: Procedures for Reducing Underreporting", 2 Tax Revision Compendium (1959), 1527 at p. 1530.

CHAPTER 3

THE TAXATION OF BENEFITS AND ALLOWANCES FROM AN OFFICE OR EMPLOYMENT 1/

INTRODUCTION

Recent years have witnessed a substantial increase in the variety and quantum of benefits and advantages other than salaries and wages, provided by employers for their personnel, both at the executive and other levels of employment. 2/ With regard to company executives, these benefits are probably the progeny of high tax rates, which make salary increases for highly paid help considerably less attractive than they would otherwise be, and a desire for security for the future of employees and their families. 3/ Employers who are anxious to acquire or retain superior management personnel may offer a wide variety of inducements ranging from pensions, death benefits, life insurance, medical, surgical and hospital insurance, deferred compensation, and liberal expense accounts and allowances, to more immediate advantages, such as country club facilities and the use of company cars, boats and other property. Thus, while it may well have been true twenty years ago that "Compensation in kind will ordinarily be small and confined largely to people at the bottom of the income scale" 4/ the same can hardly be said today.

Employees other than executives, also in quest of security and additional compensation, have enjoyed wage extras in the form of pensions, group life and health insurance, free or subsidized meals and lodging, profit sharing, paid holidays, annual vacations, commodity discounts and recreational facilities, such as free tennis courts and swimming pools, some of which have

been voluntarily granted by employers, and others, tenaciously bargained for by labour unions.

The payment of cash "allowances" to officers and employees for a multitude of purposes has long been a practice of Canadian employers. To the extent that such allowances are used by the recipient to defray personal rather than business expenses, they constitute remuneration fully as much as salary and wages. In view of the substantial proportions which fringe benefits, and perhaps allowances, have apparently assumed in Canada, the question of their liability to taxation is of first importance to employers and employees, and also to the tax authorities, who are interested not only in the potential revenue but also in any inequality in the taxation of persons receiving the same income. A disparity in the tax treatment of an employee who receives all his compensation as salary and wages and one who receives the same amount of compensation but partly in the form of fringe benefits and allowances is not defensible. It will be convenient to deal first with benefits and then with allowances.

THE TAX TREATMENT OF BENEFITS

A fundamental principle of the common law concept of income is that only money or something capable of being turned into money can constitute income for tax purposes; a mere benefit or advantage, which may be of value to the person who enjoys it, is not includible in his income. The leading authority for this proposition is the decision of the House of Lords, in Tennant v. Smith. 5/ In that case the appellant, a bank agent, was bound, as part of his duty, to occupy the bank house in order to care for the premises and to be on hand for the transaction of any special bank business after hours. He was not allowed to sublet the house or use it for other

than bank business. In deciding whether the appellant was entitled to certain relief from taxation which was granted to persons whose total income was below a stipulated amount, the House of Lords held that the value of his residence had been improperly included as part of his income from an office or employment. As has been pointed out elsewhere, 6/ the ground for the court's decision may have been that, since a free residence was not "beneficially received" by the appellant, its value did not constitute income to him. That is to say, just as a sum of money paid by a master to his servant to be expended by the servant on the master's behalf and for which the servant is accountable, is not income to the servant, so, too, the value of living accommodation occupied free of charge by a servant in the course of his duties and for the benefit of his master is not income to the servant, even though he derives some advantage by not having to rent other quarters. However that may be, certain statements made by members of the court have since been interpreted as establishing the principle that only money or what is convertible into money can constitute income. Some of their Lordships based their decision on the narrow ground that the language of Schedules D and E, under which alone the appellant fell to be taxed, extended only to money payments or payments convertible into money, and was not apt to tax other benefits. Lord Macnaghten was not content to rest his judgment on any strict interpretation of the language of the schedules:

The real answer is, that the thing which the Crown now seeks to charge is not income,... [The duty under Schedules D and E] is a tax on income in the proper sense of the word. It is a tax on what "comes in"—on actual receipts.... No doubt if the appellant had to find lodgings for himself he might have to pay for them. His income goes further because he is relieved from that expense. But a person is chargeable for income tax under Schedule D, as well as under Schedule E, not on what saves his pocket, but on what goes into his pocket. And the benefit which

the appellant derives from having a rent-free house provided for him by the bank, brings in nothing which can be reckoned up as a receipt or properly described as income. 7/

Furthermore, a conclusion contrary to that reached by their Lordships would have involved the proposition that the taxability of free accommodation depended upon the suitability of the premises to the taxpayer. This proposition was quite unacceptable to Lord Halsbury:

...in every case where such a question arose it would be necessary to examine the particular circumstances of each man's family. If he had a large family that could not be accommodated in the house, and he must hire a house elsewhere, one result would follow. If he was a bachelor, and the house was appropriate to his wants, then another result would follow.

I cannot think that the legislature ever contemplated such an examination or discrimination of persons subject to taxation as such a system of assessment would imply. 8/

Both Lord Watson and Lord Macnaghten remarked that, although the Act contained express directions for estimating and calculating the value of property for certain purposes, it contained no direction for estimating or bringing into account any benefit or advantage or enjoyment derived from free residence.

The rule in Tennant v. Smith that only money or what is convertible into money can constitute income has probably been part of Canadian income tax law from its inception in 1917. The rule appears to have been regarded as applicable under the Income War Tax Act, 9/ although there is no Canadian judicial authority to that effect. In a recent case arising under the Income Tax Act, McCullagh Estate v. M.N.R., Thurlow J. quoted with approval from the judgment of Lord Macnaghten in Tennant v. Smith that a person is taxable not on what saves his pocket, but on what goes into his pocket. 10/

Income War Tax Act

There is only slight judicial authority that bears on the question of the taxability of benefits or advantages under the Income War Tax Act. 11/ In Malkin v. M.N.R., MacLean J. commented by way of obiter dicta on section 3(1)(e) of that Act, which included in the definition of income "personal and living expenses when such form part of the profit, gain or remuneration of the taxpayer". His Lordship said:

It seems quite clear that s. 3(e) of the Act contemplates a situation where the taxpayer, for services rendered, receives as salary or remuneration (1) money, and (2) something in addition to the money by way of either (a) a living allowance in money, or (b) the free use of premises for living purposes, or (c) some other allowance or perquisite, all or any of which may as a matter of sense and right be considered as part of the gain, salary or remuneration of the taxpayer. [Emphasis added.] 12/

The mention of "the free use of premises for living purposes" bears out the opinion of one writer that the provision probably had the effect of overriding the principle that the value of free living quarters which the occupier was not free to let and could not, therefore, be turned to pecuniary account, did not constitute income. 13/

The same section of the Act received consideration by the Exchequer Court in Salter v. M.N.R. 14/ The appellant was president of a company that decided in 1938 to provide annuities for certain of its employees. The company agreed to pay the premiums on an individual policy taken out for the appellant so long as he remained in its employ. The policy provided for a monthly payment to the appellant commencing in 1944 and to continue for his lifetime, with payments for 10 years guaranteed, his wife to be the beneficiary of the guaranteed payments in the event of his early death. If

he left the service of the company prior to the due date of the first annuity payment, all benefits of the annuitant and the beneficiary were to terminate on the date that such service ended, and the insurer was bound to pay to the annuitant in one sum only an amount equal to the sum of all premiums then paid, or the cash surrender value of the policy, whichever should be the greater. Upon the termination of his services in 1942, the company assigned all its control and interest in the policy to the appellant who paid the last premium and instructed the insurance company to pay any further benefits in the annuity which might be available to him to his wife upon his death. The premiums paid by the company were considered by the tax authorities to constitute additional income in the hands of the appellant, who argued that since he never received the payments, directly or indirectly, although at some future date he might receive benefit from them, they were not income. Cameron J. held that the sums were taxable. The premiums had been paid to or for the benefit of the taxpayer or his family, he said, and hence were "personal and living expenses" forming part of the profit, gain or remuneration of the taxpayer, and constituting part of the gain, benefit or advantage accruing to the taxpayer under the annuity contract, within the meaning of sections 3(1)(e) and 2(r)(ii) of the Income War Tax Act, which read as follows:

Sec. 3(1). For the purposes of this Act, "income" means the annual net profit or gain or gratuity, whether ascertained and capable of computation as being wages, salary, or other fixed amount, or unascertained as being fees or emoluments, or as being profits from a trade or commercial or financial or other business or calling, directly or indirectly received by a person from any office or employment...and shall include... the annual profit or gain from any other source including

- (e) personal and living expenses when such form part of the profit, gain or remuneration of the taxpayer or the payment of such constitutes part of the gain, benefit or advantage accruing to the taxpayer under any estate, trust, contract, arrangement or power of appointment, irrespective of when created.

Sec. 2(r) "personal and living expenses" shall include inter alia—(ii) the expenses, premiums or other costs of any policy of insurance, annuity contract or other like contract if the proceeds of such policy or contract are payable to or for the benefit of the taxpayer or any person connected with him by blood relationship, marriage or adoption.

The fact that the appellant had only limited control over the policy and could hardly have been in a position to convert it into cash was of no apparent importance in determining the taxability of the "benefit" conferred on him, which may fairly be described as a non-forfeitable right to receive in the future either monthly annuity payments, or in certain events, a lump sum payment. The value of the annual benefit to the appellant may well have been less than the full amount of the premiums, since certain of the rights purchased by his employer were withheld from him. However, in view of the definition of "personal and living expenses" as "the expenses, premiums or other costs of any...annuity contract", the inclusion in his income of the whole of the premiums would seem to have been warranted. 15/

A contrary result was reached by the Tax Appeal Board in Fuller v. M.N.R., 16/ where the appellant was assessed under sections 2(1)(r)(ii) and 3(1)(e) of the Income War Tax Act in respect of annuity premiums paid on her behalf by her employer. Under the terms of the annuity contract, the appellant was entitled to receive fixed monthly payments for her lifetime, the first of such payments to be made when she reached the age of 56. If she died before 120 monthly payments had been made, her employer was entitled to receive from the insurer the balance of the 120 payments. In the event of her death before the due date of the first payment, her employer again was entitled to receive the total premiums paid under the contract, or its cash value, whichever should be the greater. The Tax Appeal Board, without referring to the Salter case, held that the premiums were not taxable to

the appellant for two reasons. In the first place, it was very doubtful whether the proceeds of the policy could be said to be "payable to or for the benefit of the taxpayer, or any person connected with him by blood relationship, marriage or adoption", within the meaning of section 2(1)(r)(ii), since "it could be held at the very most there is a possibility the proceeds would be payable to her". Secondly, even if the premiums did constitute "personal and living expenses", they did not form part of the gain or remuneration of the taxpayer within the meaning of section 3(1)(e), since, under certain circumstances, "the premium amounts paid by the employer would be refunded to him or the unpaid balance of the 120 monthly instalments guaranteed the appellant would also be paid to her employer". The appellant's conditional right to future payments is readily distinguishable from the non-forfeitable rights of the taxpayer in Salter v. M.N.R., where the opposite result was reached.

Although it is difficult to spell out from this paucity of authorities the precise extent to which benefits and advantages were taxable under the Income War Tax Act, it is probably accurate to say that benefits whether convertible into cash or not, received as remuneration for services and constituting "personal and living expenses" were taxable as income.

Income Tax Act

It is not easy to conceive of a more inclusive definition of income from an office or employment than that provided in section 5 of the Income Tax Act. 17/ The part of this section which deals with the taxation of benefits reads as follows:

5(1) Income for a taxation year from an office or employment is the salary, wages and other remuneration, including gratuities, received by the taxpayer in the year plus

- (a) the value of board, lodging, and other benefits of any kind whatsoever (except the benefit he derives from his employer's contributions to or under a registered pension fund or plan, group sickness or accident insurance plan, medical services plan, supplementary unemployment benefit plan, deferred profit sharing plan or group term life insurance policy) received or enjoyed by him in the year in respect of, in the course of, or by virtue of the office or employment....

The Exchequer Court has held that the purpose of paragraph (a) "...is to extend the meaning of 'income from an office or employment' beyond the normal concept of 'salary, wages and other remuneration, including gratuities' by including in that term the value of board, lodging and other benefits which an employee may receive or enjoy in the course of, or by virtue of, his office or employment". ^{18/} We turn now to a consideration of the tax treatment of board and lodging.

BOARD AND LODGING

Taxability

It is clear from Williams v. M.N.R. ^{19/} that section 5(1)(a) nullifies the effect of the decision in Tennant v. Smith, that the value of board and living quarters supplied to an employee free of charge, and which cannot be turned to pecuniary account by the employee, is not taxable as income. In the Williams case, the appellant resided with his family in Vancouver and was employed as a marine engineer on a steamship where he was supplied with meals and living accommodation without charge during his employment, as was required of every ship owner by the Canada Shipping Act. His contract of employment provided that the benefits were furnished "...in consideration of...services to be duly performed". The appellant appealed from an assessment in respect of the value of these benefits, which the parties agreed to be \$228.00, on the ground that, as his employer was required by law to

provide them, the appellant had no option in the matter and that, therefore, their value should not be considered as part of his income. Cameron J. held that the board and lodging were taxable under section 5(1)(a). He said:

The question is not whether the employer supplied the benefits because of the requirements of the Canada Shipping Act or whether it did so by voluntary contract or otherwise—but whether the appellant did receive or enjoy them in 1952 in respect of, or in the course of, or by virtue of his employment, and my finding must be that he did. 20/

Not every provision of living accommodation for an employee constitutes "lodging" within the meaning of that term in section 5(1)(a), according to the recent decision of the Tax Appeal Board in Sorin v. M.N.R. The appellant was unmarried and made his home with his brother. His duties at the hotel where he was employed often required his presence until the early hours of the morning. Rather than disturb his brother's home, he followed the practice of staying at the hotel on late nights in room 23, where he also took afternoon naps because of his strenuous night duties. The room was also used for storing cartons of hotel records, tools, and a spare television set. It was held that the room did not represent "lodging" to the appellant:

Mr. Sorin's uncontradicted evidence was that he made his home with his brother. Therefore, it seems unrealistic to me to argue that Parliament intended to levy a tax on the appellant herein for the privilege of using a room for cat naps and short rest periods each business day, under the pretext that he was being provided "lodging", where the taxpayer in question was obliged to perform his duties under very exhausting conditions. 21/

The decision provides little positive assistance in determining what does constitute "lodging" for tax purposes.

As a matter of administrative practice, the Department of National Revenue requires the inclusion in income of the value of board and lodging

and rent-free and low-rent housing. Information Bulletin No. 24, issued on February 12, 1964, provides that the following amounts, inter alia, are to be included in income:

1. Board and lodging.—The Income Tax Act specifically refers to board and lodging as a benefit derived from the employment. This includes board and lodging regularly furnished as a perquisite of the employment, as is common, for example, in the case of hotel employees and domestic and farm help. Normally the value placed on this benefit should reasonably approximate the lesser of fair market value or the cost to the employer.

Where this perquisite is not furnished free, but at an unreasonably low rate, there is a taxable benefit equal to the difference between the amount charged the employee and a reasonable valuation of the board and lodging supplied.

2. Rent-free and low-rent housing.—Where an employer provides a house, apartment or similar accommodation to an employee rent-free or for a rental that is lower than the employee would have to pay someone else for similar accommodation, the employee receives a taxable benefit. It is the responsibility of the employer to reasonably estimate the amount of such a benefit.

Valuation

The statute requires that the value of board and lodging and other benefits be brought into income. But far from providing any standard or direction for assigning a money value to benefits, section 5(1)(a) does not even specify what value is intended, whether (i) the value to the employee, (ii) fair market value, or (iii) the value to the employer or other person providing the benefit, that is, the cost. 22/ There is a dearth of Canadian judicial authority on the question of the valuation of board and lodging, and such authority as there is contains little discussion of principles. 23/

Value to the Employee. In Tennant v. Smith, Lord Watson remarked in the course of his reasons for judgment that the value to a servant of free residence "is not the price which other persons might be prepared to pay for

the privilege, but the benefit which he personally derives from it, estimated in money". 24/ In a case dealing with the valuation of shares, Ede v. Wilson, shares in a parent company were purchased at less than market value by employees of a subsidiary company, who gave a verbal undertaking not to sell such shares without the permission of the directors of the parent company so long as they remained in the employ of the subsidiary. It was held that the privilege of buying shares at an undervaluation had some worth, in respect of which the employees were assessable, but the case was remitted to the Commissioners for a valuation, in view of the restriction on the sale of the shares. In the course of his reasons and at the end of his judgment in reply to statements by counsel, Wrottesley J. made the following observations with respect to valuation of the shares:

Thus, to a man not likely to need to sell them, they will doubtless hold their full value as on the stock exchange. To a man who has no other capital they may possibly have a lesser value;...[the value] may be very different in the hands of different persons....To a well-to-do person with capital of his own already it may be worth the stock exchange value; to another man it may not. 25/

By a parity of reasoning, an inconvertible benefit in the form of board or lodging would likewise be valued in the light of the personal circumstances of the employee.

That "value" likely means "value to the employee" rather than the value or cost to the employer is supported by a South African case, Income Tax Case No. 210, where the appellant was required by the conditions of his engagement of service to reside in an isolated locality having no amenities whatsoever from a social or residential point of view. The test for determining the occupational value of the premises in respect of which he was assessed was held by Dr. Manfred Nathan, K.C., to be the value of the

premises to the employee and not the value to his employer. The learned judge said:

But it seems to us, when we have to consider the value of what is enjoyed by the appellant, that it must be the value from the point of view of the appellant. The appellant is the person who pays the tax, and he is paying in respect of what he receives, and what he receives is not what the company thinks it ought to get, but what is the value to him.... The actual owner of the house or the employer may put a fictitious value on the house. He may have regard to his ability to recoup himself for his expenditure, or the price the property may command in the market, but so far as the appellant is concerned, he is only interested in what is the value of the property which he enjoys, or the allowance connected with it. 26/

Similarly, in Case 15, the inclusion of £65 in the assessable income of an Australian farm hand as the value of board and lodging was disputed on the ground that a deduction of only £39 was allowed to the employer for the cost of food provided by him for the taxpayer. The Australian Taxation Board of Review explained the apparent anomaly by pointing out: "The value of a meal is usually, and indeed necessarily, greater than the cost of the food as such, when the labour and expense of preparation and the value of the service are taken into account". 27/

If "value" in section 5(1)(a) means "value to the employee", the individual circumstances of each employee sought to be taxed in respect of board and lodging provided by his employer would have to be examined with care. This interpretation gives rise to serious administrative problems. It would be important to consider, for example, whether the employee, required to live on the business premises, could live at home with his parents without charge; or whether the free accommodation was better than he would have chosen to meet his needs, or was a duplication of already existing facilities, as where the employee maintained another dwelling for

his family and hence benefited little, if any, from the provision of accommodation by his employer. Another factor to be taken into account would be the lack of free choice in the selection of a meal or living quarters, neither of which might be what the employee's personal tastes would have dictated. Thus, a ravenous eater, a dieting employee and a vegetarian might well report different amounts as the value of equal portions of the same food supplied free of charge or at a reduced rate in the company cafeteria. The difficulties to which the "value to the employee" view may give rise have been described in connection with the valuation of board and lodging under United States income tax law as follows:

If the meals or quarters are better than the employee would select on his own, the troublesome question arises whether their fair market value should be discounted. If the full value of the higher standard of living is taxed, the tax must come out of the employee's cash remuneration or other income; moreover, the luxury he enjoys may be worth less to him than to that part of the public which demands it and sets its "fair market value". On the other hand, the employee is enjoying a higher standard of living, whether he would have chosen it or not, and in this he resembles the rising executive or lawyer who lives beyond his means for business reasons. Perhaps the employee should be allowed to discount the fair market value without necessarily bringing it as low as he would spend if he had a free choice. Such an approach can be only an ideal to aim for in any event; frequently neither the fair market value nor the employee's standard in the absence of the employer's subsistence can be gauged with accuracy. It might also be urged that if meals and quarters are poorer than the employee would have selected, he ought to be taxed on something less than their fair market value because they are worth less than that to him. It would be a little odd, however, if a physician reported less than a janitor in respect of the same meals at a hospital. 28/

Fair Market Value. Conceivably, "value" in section 5(1)(a) may mean "fair market value", that is, the amount which a willing lessor or restaurateur might obtain from a willing lessee or customer, in the case of living accommodation and meals respectively. This appears to have been the view of the Minister of National Revenue, Dr. McCann, when he said:

With reference to the amount which is regarded as income for board and lodging, that is fixed largely by the current rates in the community. For instance, there are some mining communities where they pay a wage, and a man has to make his own arrangements for board and lodging. In a mining camp I was in only a few weeks ago in the Blind River district, the rate is \$2 per day because that is the current rate in that community for board and lodging. 29/

It may be noted here that benefits received by an employee which are convertible into cash—as distinguished from such benefits as board and lodging which an employee may enjoy but not turn to pecuniary account—have been held to be worth their fair market value. For example, the value of the benefits received by an employee who buys shares in his employer company for less than their market value has been held to be the difference between the price he pays for them and their market value at the time of allotment. 30/ Similarly, an employee who received a gift of a new suit of clothes as a perquisite of his employment was held to be taxable, not on the cost of the suit to the employer (£14), but rather on the price which it would have fetched second-hand if it had been sold immediately the employee acquired it (£5). 31/

Cost to the Employer. It is most unlikely that "value" in section 5(1)(a) means "cost to the employer". For one thing, just as the quality of a receipt as income or capital is determined according to its status in the hands of the recipient and regardless of its character in the hands of the payer, so, too, it seems reasonable to regard the value of a taxable benefit as its value in the hands of the employee, rather than its cost to the employer. For another thing, if Parliament had intended to tax employees on the basis of the cost of their employment benefits, it could have used that term. In the United Kingdom, the decision in Wilkins v. Rogerson—the "new suit" case discussed above—evoked editorial comment recommending

"...an amendment of the law in respect of benefits in kind so that they are all aggregated with other income, not on the basis of their market value, but on their cost to the employer". 32/ While such a measure may be justifiable in the economy of the United Kingdom, 33/ it could well work hardship on the Canadian scene in circumstances where board and lodging are provided to employees in remote northern areas or in isolated mining and logging camps at considerable expense to employers. The inclusion of these benefits in the income of employees on the basis of their cost would almost certainly result in a feeling of grievance on the part of the employees, and might well require employers to compensate them with increased wages, thereby augmenting business costs, and might also make recruitment of staff more difficult.

Moreover, where an employee is provided with far more expensive lodging than he would have chosen for himself in order to meet a business objective of his employer—say, the entertainment of clients—it seems unfair to tax the employee on the whole of the cost to the employer, as occurred in the English case of McKie v. Warner. 34/ In that case the employer was appointed export sales supervisor of a company which considered it essential that he should move into London to enable him to carry out his duties satisfactorily, and told him to look for a flat that suited him. On one being found, the company took a lease of it at a yearly rent of £500 and charged the taxpayer £150 for the flat, that being the sum which it considered proper having regard to the salary he was receiving. The company thus bore the expense of some £350 per annum in respect of the flat. It was part of the taxpayer's duties to entertain at the flat foreign buyers visiting the country. A bedroom was available for them, but it was also used from time to time by a member of his family. Plowman J. held that, on

a construction of the relevant provision in the Income Tax Act, the £350 was includible in the taxpayer's income as a benefit.

On the other hand, the use of "cost" as a basis of valuation would seem clearly preferable, from an administrative point of view, to both the "value to the employee" basis, which rests on the individual circumstances of the employee, and the "fair market value" basis. Clearly, there is no statutory authority for the method of valuation described in Information Bulletin No. 24, issued by the Department of National Revenue on February 12th, 1964: "Normally the value placed on this benefit [board and lodging] should reasonably approximate the lesser of fair market value or the cost to the employer". This method probably results in valuations that are satisfactory both to the Department and to many employees, including those situated in remote areas. It would not likely be satisfactory to employees who maintain another establishment and, hence, save little, if any, living expenses by reason of the accommodation provided by the employer, and who are required for business reasons to occupy employer-provided premises which are far more lavish than they would have chosen to meet their needs.

Exemptions and Deductions

Section 5(2) provides for the exclusion of the value of board and lodging from the income of construction workers in certain circumstances:

5(2). Notwithstanding subsection (1), in computing the income of a taxpayer for a taxation year from an office or employment, where the taxpayer was, during the year, employed as a construction worker, there shall not be included

- a) the value of...board and lodging, received by him
 - (i) in respect of, in the course of or by virtue of his employment as a construction worker at a construction site from which, by reason of distance from the place where he maintained a self-contained domestic establishment (hereinafter in this subsection referred to as his "ordinary place of

- residence") in which he resided and actually supported a spouse or a person dependent upon him for support and connected with him by blood relationship, marriage or adoption, he could not reasonably be expected to return daily to his ordinary place of residence, and
- (ii) in respect of a period while he was required by his duties to be away, for a period of not less than 36 hours, from his ordinary place of residence....

Section 11(1)(q) grants a deduction to clergymen of the value of the residence occupied by them or of the rent paid by them for a residence, as follows:

11(1). Notwithstanding paragraphs (a), (b) and (h) of subsection (1) of section 12, the following amounts may be deducted in computing the income of a taxpayer for a taxation year:

- (q) where a taxpayer is a member of the clergy or of a religious order or a regular minister of a religious denomination, and is in charge of or ministering to a diocese, parish or congregation, or engaged exclusively in full-time administrative service by appointment of a religious order or religious denomination, an amount equal to
- (i) the value of the residence or other living accommodation occupied by him in the course of or by virtue of his office or employment as such member or minister so in charge of or ministering to a diocese, parish or congregation, or so engaged in such administrative service, to the extent that such value is included in computing his income by virtue of section 5, or
- (ii) rent paid by him for a residence or other living accommodation rented and occupied by him, or the fair rental value of a residence or other living accommodation owned and occupied by him, during the year but not, in either case, exceeding his remuneration from his office or employment as described in subparagraph (i).

OTHER BENEFITS

Section 5(1)(a) requires the inclusion in income from an office or employment of "...other benefits of any kind whatsoever...received or enjoyed..." by a taxpayer. It has been said that "...the concept of

'benefit' is essentially pragmatic and elastic, as it must be in order to handle 'all the protean arrangements which the wit of man can devise' as compensation". 35/ The term "benefit" is not defined in the Income Tax Act, and has been the subject of very little discussion by the courts.

Mr. R.S.W. Fordham in No. 126 v. M.N.R. noted that "Neither of these words ['benefit or advantage'] is defined in the Act, but I am content to take the meaning given to each at pages 169 and 27, respectively, of the Shorter Oxford English Dictionary, as they are not words that are difficult to understand". 36/

He held in Reininger v. M.N.R. that "A benefit, property so called, usually indicates an advantage of some kind or another. In the Shorter Oxford English Dictionary, 3rd ed., at page 169, 'benefit' is stated to mean 'advantage, profit, good'. It is probably correct to say that if there is no advantage, there is no benefit". 37/ It is probably equally correct to say, however, that not every advantage is a benefit within the meaning of section 5(1)(a). The question remains, what kinds of benefit are taxable under that provision?

Since we are concerned with the meaning of a term in a taxing statute, and in view of the fact that the benefits contemplated by section 5(1)(a) must be capable of being evaluated in money, to say that Parliament intended to tax only benefits of a pecuniary or economic nature, to the exclusion of aesthetic, moral or spiritual benefits, is perhaps only to state the obvious. Thus, an employee who is rewarded with a status symbol such as a high-sounding title may derive pleasure and satisfaction but not a taxable benefit from it. Moreover, certain other advantages would seem to fall outside the pale of taxation as being conditions of employment, which Parliament could

hardly have intended to tax. Into this group would fall such items as air-conditioning, lighting, heat, recorded music, washrooms, office space and attractive and spacious surroundings. But a precise line of demarcation between clearly taxable benefits conferred as compensation and non-taxable benefits that are part of the working conditions is not easily drawn. An employer interested in maintaining or increasing production may take steps to promote the health, efficiency and contentment of his employees by providing free medical check-ups or free recreational facilities such as swimming pools and tennis courts, which, on the one hand, may save the employees money and so constitute a benefit to them, and, on the other hand, from the employer's viewpoint, are in the same category as better lighting and washrooms.

It is conceivable that minor benefits of little value might be excluded on the principle of de minimis non curat lex. ^{38/} Such items as the value to an employee of the employer-sponsored summer picnic or the annual Christmas cake distributed to all staff members might fall into this category.

Judicial opinion as to the application of the ejusdem generis rule to section 5(1)(a) as it stood prior to the 1956 amendment was not unanimous. ^{39/} In No. 247 v. M.N.R., the argument that "other benefits" referred to benefits of the same nature as the preceding words, that is, board and lodging, met with failure. Mr. Fordham reasoned that "...the words 'other benefits', considered in relation to section 5(a) as a whole, are of general import and can include the right to purchase shares. The excepting words in brackets in para. (a), for instance, are far removed from anything akin to board and lodging". ^{40/} The opposite view was

entertained by Mr. W. S. Fisher in Pazuk v. M.N.R., where he remarked:

"Were it not for the decision of my colleague Mr. Fordham in No. 247 v. M.N.R., ...I might have arrived at the conclusion, from my own interpretation of the said phrase, that the ejusdem generis rule did apply and that 'other benefits' would have to be construed as benefits similar to 'board and lodging', and that this would be so in spite of the fact that after the word 'benefits' there is set forth an exception...." 41/ The addition of the words "of any kind whatsoever" to "other benefits" in 1956, 42/ would appear to have resolved the issue and left little scope for argument in favour of the application of the rule to the section as amended. 43/

Since section 5(1)(a) requires the inclusion in income of the value of benefits, the Tax Appeal Board has held that the provision extends only to benefits "in a form other than cash, upon which it is necessary for some valuation to be put". 44/ Cash payments are taxable as salary, wages, gratuities, other remuneration or allowances.

A fundamental limitation on the meaning of "benefits" has been suggested by one member of the Tax Appeal Board. In Pazuk v. M.N.R., the appellant was assessed under section 5(1)(a) as having received a benefit from his employer's contributions to a pension fund. Mr. Fisher, whose judgment was concurred in by Mr. Snyder, said:

It might be thought that by virtue of his employment with an employer who set up a group insurance plan to provide an ultimate annuity upon the retirement of each and every employee this taxpayer was being saved the expense of providing for his own retirement. It has long been settled tax law, however, that unless specific and clear provisions of the law make such items taxable income includes only that which comes into the pocket and not that which saves the pocket. 45/

While it may be true that the common law concept of "income" includes only that which comes into the pocket, there is nothing inherent in the elastic and pragmatic concept of "benefit" or in the language of section 5(1)(a) to warrant the making of a distinction between benefits that come into the pocket and those that save the pocket. On the contrary, by requiring the inclusion in income of benefits merely "enjoyed" as well as those "received", Parliament would seem to have intended to reach benefits which result in a saving to the taxpayer.

Having examined briefly some of the factors that may serve to define in broad outline the general scope of section 5(1)(a), we turn now to a consideration of specific benefits whose taxability has been considered by the courts. 46/

Use by an Employee of his
Employer's Property

In No. 350 v. M.N.R., the president and managing director of a company was taxed in respect of the value of the benefit received by him from the use, for his private purposes, of an automobile owned by the company. 47/ In computing the value of the benefit, the court estimated the appellant's personal use of the car as a percentage of the total mileage and added to his income that percentage of the total cost of operation, including depreciation, gas, oil, washing and insurance. The same system was used in Curtis v. M.N.R., 48/ Sherman v. M.N.R., 49/ and No. 592 v. M.N.R. 50/ This method is not in keeping with the principle discussed earlier, that valuation depends upon matters personal to the individual employee, although it does have the virtue of simplicity, and in the case of one-man companies, where the major shareholder-officer has the choice of selecting the company car, knowing that it will also be used for personal purposes, the

percentage-of-cost method is probably a satisfactory measure of the value of the benefit to him. On the other hand, a junior executive whose needs would be satisfied by an automobile of modest price, but who is required by his employer to drive a large and expensive company car for the business purpose of maintaining prestige, might well regard himself as unfairly treated if he were taxed on the percentage-of-cost method. Information Bulletin No. 24 authorizes the use of the percentage-of-cost method:

3. Personal use of employer's automobile.—Where an employee is permitted to make personal use of an automobile maintained by his employer he should include in income the value of the benefit to him arising from the personal use made of the automobile. Normally the value of that benefit is that proportion of total operating costs of the automobile that his personal use bears to its total use in the year. For this purpose, "operating costs" include such things as licenses, insurance, repairs, gasoline, oil, servicing charges and rentals paid that are dependent on miles of use. However, operating costs in respect of an automobile used substantially for business purposes need not include capital cost allowances or rentals not dependent on miles of use, such as are common when the employer's practice is to rent a fleet of cars for a long term.

Benefits Enjoyed by an Employee's Family

There is judicial authority for the proposition that the value of benefits conferred by an employer on the family of an employee, who is thereby saved from incurring expenses, is taxable to the employee. In No. 510 v. M.N.R., 51/ amounts were added to the taxpayer's income in respect of room and board provided for himself and his wife by his employer. Although it is not clear from the decision, the benefit enjoyed by the wife could have been assessed to the taxpayer only as "other benefits", for meals consumed by her could hardly be considered as "...board...received or enjoyed by" her husband. 52/ And in No. 592 v. M.N.R., 53/ the percentage of the cost of operation of two company-owned cars and a cabin cruiser

attributable to the use made of these vehicles by the appellant's wife was taxed to the appellant, the major shareholder, probably on the ground that he was saved the expense of having to provide her with other means of transportation.

Purchases of Shares by Employees
at an Undervaluation

The privilege of buying shares at a lower-than-market price, with no restriction as to the time and place of resale, was held in Snell v. M.N.R. to be "distinctly an advantage from the appellant's point of view.... Consequently, what the appellant derived can properly be regarded as embraced by the words 'and other benefits' as found in [section 5(a)]". 54/ The value of the advantage was held to be the difference between the amount paid for the shares and their market value at the time of purchase. 55/

Loans to Employees

An employee who is permitted to borrow money from his employer for his private purposes may clearly enjoy a benefit, within the ordinary meaning of that word, in at least two respects. First, he may be too doubtful a credit risk to obtain funds from a commercial lender, and secondly, if the loan is made free of interest, the saving of expense which he would ordinarily incur in borrowing money is a real advantage. The case of Reininger v. M.N.R., 56/ is instructive with regard to the first kind of benefit. A company of which the appellant was principal shareholder loaned money at 5 per cent interest to his wife, who gave a demand note to the lender but no security. In determining the tax liability of the husband in respect of the loan, it was necessary for the court to decide whether the wife had received a "benefit" within the meaning of section 16(1). 57/ After discussing the meaning of "benefit" generally and quoting a dictionary

definition of that word, 58/ Mr. Fordham concluded that she had. "It seems to me", he said, "to be more than doubtful that any bank, or other financial institution, would have lent money to the appellant's wife on such easy terms—or even at all, for that matter—and that, accordingly, what she derived from the company's action was a benefit within the meaning of section 16(1)...." 59/ Unless "benefit" has a different meaning in section 16(1) than it has in section 5(1)(a), an employer who lends money at the legal rate of interest to an employee who is unable to provide any security confers a benefit on him, the measure of which might be taken to be the difference between the interest charged by the employer and the rate of interest the employee would have had to pay to a financial institution that would have lent money without security—say, a finance company.

From the point of view of an employee, the free use of an employer's property, whether in the form of an automobile on the one hand, or money on the other, results in a benefit in the form of a saving of expenses. However, in No. 359 v. M.N.R., 60/ it was held that a company did not confer a "benefit", within the meaning of sections 5(1)(a) and 8(1)(c), on a shareholder by lending him \$97,000 interest free. The Minister had valued the benefit at 4 per cent of the amount of the loan outstanding. Mr. W. S. Fisher held: "Apart from specific legislation in a taxing statute, I know of no law which imposes an obligation upon a lender to demand the payment of interest in connection with a loan granted by the lender to a borrower, and if the lender does not require the payment of interest, the borrower is under no obligation to pay interest". 61/ But surely it is the absence of the obligation to pay interest for the use of money, just as it is the absence of an obligation to pay rent for the use of a company car, that results in a benefit to the employee in the form of a saving of expenses.

More recently, the problem raised by interest-free loans was again considered by the Board in Pillsbury Canada Limited v. M.N.R. 62/ The appellant company borrowed large sums of money from two companies which it controlled through stock ownership, the loans being evidenced by promissory notes bearing interest at $4\frac{1}{2}$ per cent per annum. When the principal amounts were repaid, each of the creditors elected to waive the interest owing, in respect of which sums the appellant was assessed as having had benefits conferred on it within the meaning of section 8(1)(c). In giving judgment for the taxpayer, Mr. Fordham followed No. 359 v. M.N.R., *supra*, and also applied the law of England, to the effect that "Where...—and this is the case now before the Board—the partial or total remission of a debt amounts to no more than a saving by the debtor, it is not income accruing to him". [Emphasis added.] 63/ But to say that a saving is not income, apparently because nothing comes into the pocket, is far from saying that a "saving" may not be a benefit, the value of which is made taxable by aptly worded legislation, such as sections 5(1)(a) and 8(1)(c). The Exchequer Court affirmed the decision on other grounds. 64/

The decision of the Tax Court of the United States in Dean v. Commissioner 65/ is instructive on the question of whether an interest-free loan results in a benefit to the borrower. The taxpayers in that case had outstanding interest-free loans in excess of \$2,000,000 which they had obtained from a corporation controlled by them. The Commissioner contended that they realized income to the extent of the economic benefit derived from the free use of the borrowed funds, and that such economic benefit was equal to the prime rate of interest (from 3 per cent to 4 per cent) at which they could have borrowed funds. In support of this contention, he relied on a series of cases holding that rent-free use of corporate property by a

stockholder or officer may result in the realization of income. A majority of the Tax Court distinguished these cases and held that the taxpayers did not realize income from the interest-free loan:

These cases bear a superficial resemblance to the present case, but reflection convinces us that they are not in point. In each of them a benefit was conferred upon the stockholder or officer in circumstances such that had the stockholder or officer undertaken to procure the same benefit by an expenditure of money such expenditure would not have been deductible by him. Here, on the other hand, had petitioners borrowed the funds in question on interest-bearing notes, their payment of interest would have been fully deductible by them under section 163, I.R.C. 1954. Not only would they not be charged with the additional income in controversy herein, but they would have a deduction equal to that very amount. We think this circumstance differentiates the various cases relied upon by the Commissioner.... 66/

The general rule provided in section 163 of the Code is that "There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness." But for this provision, which has no counterpart in the Canadian Income Tax Act, it seems plain that the Court would have equated the economic benefit arising from the free use of funds and the benefit arising from the free use of other kinds of property. Indeed, one of the judges dissented on the ground that the case before him was not distinguishable in principle from other cases "wherein it was held that the rent-free use of corporate property by a stockholder or officer resulted in the realization of income. 'Interest' in the sense that it represents compensation paid for the use, forbearance, or detention of money, may be likened to 'rent' which is paid for the use of property". 67/ Moreover, for Canadian tax purposes the decision of the majority can be distinguished on the ground that the term "benefit" in section 5(1)(a) has never been judicially interpreted to mean only those benefits which, if acquired by the employee out of his own resources, would not have been deductible by him in the computation of his income.

Information Bulletin No. 24 provides:

Where an employer lends money to an employee without interest, or at an unusually low rate of interest, he is not regarded as conferring a taxable benefit on the employee within the meaning of Section 5 of the Act. However, if the employer is a corporation and the employee is a shareholder of the corporation, Section 8 of the Act may apply.

Since both sections impose tax on "benefits", it is not clear why employees and shareholders are treated differently for tax purposes.

Payments Made by an Employer to Discharge
Employees' Pecuniary Obligations

Payments made by an employer to discharge an employee's pecuniary obligations such as income tax and maintenance costs of a home have been held to constitute income to the employee under the United Kingdom Income Tax Act, 68/ and the Canadian Income War Tax Act. 69/ Such payments would be taxable under the present Income Tax Act either as having been indirectly or constructively received by the employee or, on the basis of the following decisions under section 8(1), as benefits under section 5(1)(a). In Herbacz v. M.N.R., 70/ company funds used to pay a shareholder's income tax were held to be taxable to him as a benefit. Similarly, in Sabat v. M.N.R., 71/ a company which made a payment in partial discharge of a shareholder's personal indebtedness was held to have conferred a taxable benefit on him. 72/

Employer's Contributions to Insurance
and Pension Funds

An employee whose pecuniary obligation, such as income tax, is paid by his employer is taxable in respect of such payment in the year in which it is made, for the benefit to him is immediate. On the other hand, if an employee acquires only a contingent or conditional right to benefit at some time in the future from payments made by his employer, it has been held by

English and Canadian courts that the employee is not taxable in the year in which the payments are made.

In Edwards v. Roberts, 73/ the taxpayer was employed by a company under a service agreement dated 1921 which provided, inter alia, that in addition to an annual salary, he should have an interest in a "conditional fund", which was to be created by the company by the payment after the end of each financial year of a sum out of its profits to the trustees of the fund, to be invested by them in the purchase of the company's shares. He was not entitled to receive any part of the corpus of the fund set aside for his benefit until he had been in the service of the company for at least five years. His interest in the fund was to cease completely in the case of his being dismissed for misconduct or his assigning or creating a mortgage or charge on his salary or his interest in the fund. In the case of his death or the termination of his service owing to ill-health, the amount standing to his credit in the fund would be paid to him or his estate. In 1927, the taxpayer, with the company's consent, resigned from its service and received from the trustees the shares purchased with the payments made by the company between 1922 and 1927. He was assessed for income tax under Schedule E for 1927-28 on the value of the shares at the date of transfer. He contended that, notwithstanding the liability to forfeiture of his interest in certain events, immediately a sum was paid by the company to the trustees of the fund he became invested with a beneficial interest in the payment which formed part of his emoluments for the year in which it was made, and for no other year, and that, accordingly, the amount of the assessment for the year 1927-28 should not exceed the amount paid into the fund during the year of assessment. It was held by the Court of Appeal that the taxpayer "...had only a conditional right, that is to say,

a right as given to him conditionally upon the events mentioned in Clause 8 of the agreement being complied with, to receive the investments which might be made on his behalf at times and in the manner therein mentioned. If all those circumstances are taken into consideration...the benefits which he might conditionally become entitled to under the agreement are not in a true sense part of the salary in the wide sense chargeable under Schedule E of the Income Tax Act". 74/

In Pazuk v. M.N.R., 75/ the taxpayer was the chef at a hospital which entered into a contract with an insurance company to provide a pension plan for its employees. Contributions to the plan were made primarily by the employer. Under the policy, the insurance company agreed to pay to each employee to whom coverage extended a retirement annuity payable monthly during the lifetime of the employee after his retirement, or during 119 months, whichever period might be the longer term. An employee was to obtain a vested right to benefits provided by his employer's contributions to the extent of 25 per cent after 5 years' service, 50 per cent after 10 years' service, 75 per cent after 15 years' service and 100 per cent after 20 years' service. In the event of death before retirement, his estate would receive 100 per cent of both his employer's and his own contributions, with interest. If an employee withdrew from service before retirement and apparently after 20 years' service, he would receive 94 per cent of his own contributions and 95 per cent of 94 per cent of his employer's contributions, both with interest. The withdrawal allowance could be taken in the form of a paid-up annuity or in cash, and in the latter case a further 5 per cent was withheld. The appellant left the hospital in 1953, after 9 years' service, taking his allowance in cash, which consisted for the most part of 25 per cent of his employer's contributions.

For the years 1949 to 1951, the Minister added to the appellant's income the full amount contributed by the hospital to the fund in those years on the ground that they were income from an office or employment under section 5(1)(a) and were not contributed to an approved superannuation fund or plan within the meaning of that paragraph. The Tax Appeal Board allowed the appeal on the ground that the appellant received nothing and enjoyed no benefit in the years under review from his employer's contributions.

"Any benefit which he might receive in the future would be received either on his retirement at the normal retiring age; in the year in which he severed his connection with the employer before reaching the normal retirement age; or upon his death, in which latter case the benefit would go to his estate", said Mr. W. S. Fisher. 76/

There is another point of time at which the appellant might be considered to have received a benefit, namely, in 1949, the fifth year of his employment, when he acquired a vested right to 25 per cent of his employer's contributions. So long as his rights under the plan were forfeitable, he could not be considered to have received any benefit until actual receipt of future payments. 77/ On the other hand, there is merit in the argument that the indefeasible vesting in him of a right to 25 per cent of his employer's contributions constituted the acquisition of a benefit which he did not have before and in respect of which he could be taxed under section 5(1)(a), whether or not his non-forfeitable rights were assignable or commutable or had any loan value.

Consider the United States case of United States v. Drescher 78/ where the taxpayer's employer purchased for \$5,000 a single premium, non-assignable annuity contract, naming the taxpayer, who was then 46 years of

age, as annuitant. Under the terms of the policy, payments were to begin at age 65, with 120 monthly payments guaranteed. Although the policy had no cash surrender, salable, or loan value, he was held taxable in respect of its value to him in the year the contract was purchased. Judge Swan, who delivered the majority opinion said:

It cannot be doubted that...the plaintiff received as compensation for prior services something of economic benefit which he had not previously had, namely, the obligation of the insurance company to pay money in the future to him or his designated beneficiaries on the terms stated in the policy.... The perplexing problem is how to measure the value of the annuitant's rights at the date he acquired them.... The prohibition against assignment does not prove complete absence of present value. The right to receive income payments...represented a present economic benefit to him. It may not have been worth to him the amount his employer paid for it; but it cannot be doubted that there is a figure, greater than zero although less than the premium cost, which it would have cost him to acquire identical rights. 79/

The application of this reasoning in the Pazuk case might have resulted in the double taxation of the employer's contributions, first, in 1949, when the taxpayer acquired his "benefit", and perhaps again in 1953, when the fund was paid to him, for section 6(1)(a) requires the inclusion in income of "superannuation or pension benefits", which term is defined in section 139(1)(ar) to include "any amount received out of or under a superannuation or pension fund or plan".

Provision of Counsel by Employer to
Defend Employee Charged with Crime

In the recent English case of Rendell v. Went 80/ the taxpayer was a director of a company engaged in trade. While he was driving a company car after making a call on its business, the car unaccountably left the road and killed a pedestrian, and he was charged with causing the death of a

person by reckless or dangerous driving, for which he would be liable on conviction to imprisonment for a term of up to five years. The time of the accident was a critical one at which the company had special need of the taxpayer's services. Concerned at the possible serious loss of the business to it, in the event of the taxpayer's conviction and imprisonment, the company undertook the taxpayer's defence. The taxpayer was acquitted. The cost to the company was £641, whereas if the taxpayer had defended out of his own resources, he would have incurred £50 or £60 costs.

The Court of Appeal held that the taxpayer was taxable on the full amount of £641 which constituted an expense incurred by the company in or in connection with the provision for the taxpayer of "other benefits or facilities of whatsoever nature" within the meaning of section 161(1) of the United Kingdom Income Tax Act. The Court rejected the argument that because the company incurred the expense primarily in its own interests and only secondarily in the interests of the taxpayer, no benefit was provided within the meaning of the statute. Two of the three judges also rejected the contention that the only benefit to the taxpayer was the saving to him of the amount of money which he would have expended if he had been left to his own resources, namely £60 or so, and that the charge to tax should be restricted accordingly. Donovan L. J. held that:

Section 161(1)...does not lay the charge on the benefit. The combined effect of s. 160 and s. 161(1) is to lay the charge on the sum paid by the company as an expense in connection with the provision of the benefit. 81/

Russell, L. J. was of a similar view. However, Sellers L. J. entertained some doubt on the value of the benefit to the taxpayer when he said:

The contention of counsel for the taxpayer was—and it was this, I must say, which has appealed to me—that the benefit was only to the extent by which his pocket was relieved, and the relative inquiry is not what the company spent but what the taxpayer might reasonably be expected to spend in his own defence, that being the amount by which he was relieved and therefore benefited. However, I am not quite satisfied that the wording permits that conclusion and I am not going to dissent from the views which my lords have taken. 82/

A unanimous House of Lords upheld the decision of the Court of Appeal. 83/ In their Lordships' opinion, the provision of the legal defence was clearly a benefit to the taxpayer and, although it also benefited the company, the measure of the benefit to the taxpayer was prescribed by the statute to be the expense incurred by the company in providing it. An enquiry into what the taxpayer would have spent on his defence if he had had no help from the company did not commend itself to Lord Radcliffe, in whose judgment Lord Guest and Lord Upjohn concurred:

"I do not believe that there can be any true finding of fact about what a man would have done in circumstances that are past and in which he was never presented with the necessity of decision. But, even if there could be a real finding on such a matter, I am satisfied that it would have no bearing on the Appellant's liability to tax under section 161.... After all, it does not reduce the value of a present to say that the recipient could not or would not have bought it for himself." 84/

Lord Reid appears to have been influenced by the fact that the taxpayer consented to the provision of the defence by the company, and left open the possibility that, in other circumstances, a value other than the expense incurred by the company might be ascribed to a benefit:

"This is not a case of the company spending without the director's knowledge a large sum to procure a benefit which he did not want, and I do not intend to consider how such a case ought to be dealt with. The Appellant knew and accepted what was being done on his behalf though he may not have realized how much it was costing.

Where there is in fact a benefit and, therefore, a perquisite the Act provides that the measure of the perquisite shall be the expense incurred by the company in providing it. Whether there can ever be circumstances in which it would be possible to depart from that rule in a case where the money was wholly spent to provide the benefit is a matter which it is unnecessary to consider." 85/

Under the Canadian Income Tax Act, the provision of counsel by an employer for an employee doubtless constitutes a "benefit" within the meaning of section 5(1)(a). The amount required to be included in the employee's income in respect of the benefit would depend on the meaning of the term "value" in that provision. If it means "fair market value", the amount of the lawyer's fee would be taxable. If it means "value to the employee", there is room for argument that he should be taxed only on the amount by which his pocket was relieved, that is, the amount that he might reasonably be expected to have spent in his own defence. On the other hand, if the employee has had a free choice in deciding whether to accept the benefit, the value to him may well be the fair market value. Such a case is readily distinguishable from that of the employee who is required as a condition of his employment to live in the company house which is inadequate to his needs and would not have been occupied by him had he had a choice in the matter.

INFORMATION BULLETIN NO. 24

This Bulletin was issued by the Department of National Revenue on February 12, 1964. It enumerates certain fringe benefits, the value of which is required to be included in an employee's income, and other benefits, the value of which is not subject to tax.

According to the Canadian Tax Reporter:

When the Bulletin was issued, it was stated by the Minister of National Revenue, that in order that the employee may be in a position to report this kind of income on his income tax return, it is the responsibility of the employer to determine, and to place a value on, all benefits of a taxable nature that he provided to each employee during the course of the calendar year. Having done so, it is then required of the employer that he report, on form T4 Supplementary for that year, the total value of the taxable benefits provided to each employee. A box headed "Taxable Benefits" appears on the form T4 Supplementary for this purpose....

The Bulletin does not change the law in any way but simply states the administrative practice which has been followed for many years by the Department. 86/

The Bulletin reads as follows:

The purpose of this Bulletin is to enumerate various common types of "fringe benefits" and to indicate whether their value should or should not be included in income. In those cases where the value should be included, the employer should determine the value, or make a reasonable estimate of it when it cannot be precisely determined, and include that value in the box provided on Form T4 under the heading "Taxable Benefits". The information herein refers to cases where there is only an employer-employee relationship and does not necessarily apply if the employee is also a shareholder or a relative of the owner of the business.

Under the heading "AMOUNTS NOT TO BE INCLUDED IN INCOME", the Bulletin states:

1. Discounts on merchandise.—This refers to a percentage discount which is commonly extended to employees in merchandising businesses. The benefits that may be derived by an employee from exercising such a privilege are not regarded as taxable benefits. This does not extend to an extraordinary arrangement that may be made with a particular employee or select group of employees nor to an arrangement by which an employee is permitted to purchase merchandise (other than old or soiled merchandise) for less than the employer's cost.

The reason for this exclusion is not readily apparent. These discounts would seem clearly to constitute a "benefit" susceptible of easy valuation, at least in the case of retail merchandising businesses, namely, the amount

of the discount below the employer's normal retail price. The amount of the advantage enjoyed by employees or non-retail stores who buy at the wholesale price would be more difficult to measure. These discounts would seem to be common enough to warrant inclusion in income both on grounds of revenue and equity, particularly since they are substantial enough to be a material factor in respect of a taxpayer's cost of living. It is known that one large department store chain offers a 15 per cent discount off retail on food and 25 per cent discount on all other items to employees of supervisor rank and above. According to a recent study of the fringe benefits provided by 78 Canadian companies constituting a reasonably representative cross-section of Canadian industry and having a total of 448,512 employees, discounts on products bought through the company were provided by 25 companies having 147,030 employees, or 32.8 per cent of all employees in all 78 companies. ^{87/} A United States study contains the following statement:

Employee discounts are a common type of fringe benefit and, in some lines of business, constitute a sizable portion of an employee's income. The amount of potential revenue to be gained by taxing employee discounts appears substantial, and... these benefits should be taxed if administratively feasible. ^{88/}

2. Transportation passes.—Where, in the transportation industry, an employee is given the privilege of a free pass for himself and his family on vehicles operated by his employer, he is not regarded as receiving a taxable benefit.

Although a transportation pass may not constitute income at the time of its receipt, its use may well constitute a taxable benefit, in the opinion of Mr. W. S. Fisher of the Tax Appeal Board, who said, by way of obiter dicta in Pazuk v. M.N.R.:

On the question of whether the appellant received a "benefit" from his employer's contributions in the years under appeal, I am of the opinion that he did not. Neither, for example,

does an employee of a transportation company who, as a term of his employment, becomes entitled to a free pass annually on the company's transportation system receive any "benefit" in any year unless and until he takes advantage of his right and actually uses his pass for transportation in any specific year. 89/

In short, employees are not taxed on the mere opportunity to use the facilities, but only on the actual use made of them. The difficulty here is that a record would have to be kept of the number of times the employee used the facilities.

3. Subsidized meals.—Employers who are not ordinarily purveyors sometimes set up canteens or lunch rooms at which employees may purchase noon meals at low prices. Similar arrangements are also made for making all meals available at low prices in remote areas. In these circumstances, the employees are not regarded as being in receipt of taxable benefits unless the price charged is nominal.

The tax treatment of board provided by an employer has already been discussed above.

4. Uniforms and special clothing.—Where an employee is supplied with a distinctive uniform which he is required to wear while carrying out the duties of his employment or where he is provided with special clothing designed to protect him from the peculiar hazards of the employment, he is not regarded as getting a taxable benefit therefrom.

There can be little objection to this exclusion. A distinctive uniform which an employee is required to wear while carrying out the duties of his employment is comparable to the tools and machinery with which he works or, perhaps, even to his conditions of employment. Moreover, but for the restriction on employees' deductions in section 5, the cost of a distinctive uniform might well constitute a deductible expense to the employee. Hence, the employer who provides such a uniform is not relieving the employee of personal and living expenses as he does when he provides him with free board

and lodging and other strictly personal benefits unconnected with the earning of his employment income.

5. Tuition fees.—Where an employer requests or encourages an employee to undertake some special training or to enrol for a course of study which will increase the employee's usefulness to the employer, the cost of that training or study, if borne by the employer, is not a taxable benefit to the employee.

This exclusion can be justified on the ground that educational instruction of this kind, which presumably does not benefit the employee except in respect of his particular job, and merely serves to equip him to do his job better, is comparable to job training which enures to the benefit of the employer. Moreover, the value of the benefit to the employee would be difficult to fix.

6. Subsidized school services.—In the case of employment in remote or unorganized areas employers frequently assume, initially at least, responsibility for essential community services of a kind normally borne by a municipal organization. Where, in such a situation, the employer provides free or subsidizes school services for children of the employees, a taxable benefit is not thereby deemed to accrue to the employees by virtue of their employment. This does not extend to a payment made by the employer, on behalf of an employee, of school fees or other direct charges otherwise payable by an employee consequent upon the employee's dependants attending a school or university. The latter payments are taxable benefits.

It appears to be the valuation difficulty that underlies this exclusion.

7. Transportation to the job.—Employers sometimes find it expedient to provide vehicles for transporting their employees from pick-up points to the location of the employment at which, for security or other reasons, public and private vehicles are not welcome or not practical. In these circumstances the employees are not regarded as in receipt of a taxable benefit.

The value of transportation-to-the-job benefits is probably small, and the valuation problem could be difficult. For example, the employer-provided transportation facilities would be more valuable to an employee who lived close enough to the pick-up point to walk there and who would otherwise have driven to the plant, than to an employee who lived equidistant from the plant and the pick-up point and drove to the latter instead of the former.

8. Interest-free loans.—Where an employer lends money to an employee without interest, or at an unusually low rate of interest, he is not regarded as conferring a taxable benefit on the employee within the meaning of section 5 of the Act. However, if the employer is a corporation and the employee is a shareholder of the corporation, section 8 of the Act may apply.

This benefit is discussed above.

9. Recreational facilities.—Normally where recreational facilities are maintained by the employer and made available for use of the employees generally, free of charge or upon payment of a nominal fee, the value of any benefit derived by an employee from taking advantage of such a privilege is not taxable. However, if the employee is furnished with board or lodging, as for example where a summer hotel or hunting lodge is maintained by the employer, the value of board and lodging received by the employee must be included in his income.

Similarly, where the employer pays the fees required for some employees to be members of a social or athletic club where it is to the employer's advantage for the employee to be a member of the club, the employee is not deemed to have received a taxable benefit.

Doubtless the task of allocating a value to the benefit, if any, enjoyed by each employee from the use of such employer-provided facilities as swimming pools, tennis courts, and classes in music appreciation or dancing is virtually an impossible one. In the case of rank and file employees, the value of these benefits is probably not very great:

A fairly recent survey of 264 companies indicates that the median cost of providing this type of benefit is three dollars per employee. 90/

Since the exemption applies only in the case of recreational facilities which are "made available for use of the employees generally", it is not susceptible to exploitation for the benefit of highly paid executives who may be provided with lavish recreational facilities such as yachts, private hunting preserves, and so on. Indeed, the exemption of the personal benefit enjoyed by employees from the use of social or athletic club facilities, paid for by the employer, seems to be an unwarranted concession, although the extreme difficulty of measuring such personal benefit is recognized.

10. Removal expenses.—Where an employer reimburses an employee for the expenses incurred by the latter in moving himself, his family and his household effects either because the employee has been transferred from one establishment of the employer to another or because the employee has accepted employment at an establishment remote from his former home, this reimbursement is not considered as conferring a benefit on the employee.

In addition, where the employer pays the expense of moving an employee and his household out of a remote place at the termination of his employment at such a place, there will be no taxable benefit imputed.

The reason for this exclusion is not clear. An employee's moving costs are a personal expense, the discharge of which, by his employer, would seem to constitute a benefit within the meaning of section 5. The taxation of such a benefit poses no valuation problem nor does it impose any undue administrative burden on the employer.

Information Bulletin No. 25 was issued on June 8, 1964, to add a new section 6 to Information Bulletin No. 24. It reads as follows:

6. Premiums under Provincial Hospitalization Plans or Medical Services Plans.—Where an employer has paid the premium or a

portion thereof on behalf of an employee, the amounts paid during the year must be included as a "Taxable Benefit" when reporting the employee's remuneration.

The taxation of this form of benefit is warranted on two grounds. First, the obligation of insured persons to pay premiums is a statutory liability, so that when an employer discharges that obligation by paying his employee's premiums, he is clearly conferring a benefit in the same way as if he had paid their income tax. Secondly, to the extent that premiums paid by an employer on behalf of his employees were not included in the latter's income, there was discrimination against employees in other provinces where hospital insurance is financed from other tax revenues. Thus, an Ontario worker enjoyed a tax advantage over a Quebec worker who pays the provincial cost of hospital insurance from his wages in the form of sales tax. 91/

Among the "AMOUNTS TO BE INCLUDED IN INCOME" are (1) Board and lodging; (2) Rent-free and low-rent housing; (3) Personal use of employer's automobile; (4) Gifts, (including Christmas gifts); and (5) Holiday trips and other prizes. The first three items were noted earlier in the discussion of the tax treatment of board and lodging and the use by an employee of his employer's property. The inclusion of "gifts" and "prizes" warrants comment here.

4. Gifts (including Christmas gifts).—A gift (either in cash or in kind) to an employee is a benefit derived in the course of or by virtue of the employment. In recognition of long-standing practice, however, where the value of a Christmas or wedding gift does not exceed \$25 and where the employer does not claim its cost as an expense in computing his own taxable income the gift is not required to be reported as income of the employee.

5. Holiday trips and other prizes.—A free holiday trip or a vacation with expenses paid given by an employer to an employee

for long or meritorious service, or any prize, whether in cash or in kind, in recognition of job performance, constitutes a taxable benefit from the employment which should be measured by the cash equivalent.

The language of these two provisions is too sweeping in so far as it requires the inclusion in income of testimonials and other gifts of a purely personal nature. Such gifts were acknowledged by the Supreme Court of Canada in Goldman v. M.N.R. not to be taxable under the Income War Tax Act. 92/ The same position would appear to obtain under the Income Tax Act.

"RECEIVED OR ENJOYED"

Only benefits "received or enjoyed" by an officer or employee are required to be included in income under section 5(1)(a). The meaning of these terms, which has been little discussed by the courts, was the subject of the following parliamentary exchange:

Mr. Zaplitny: What is the distinction between the words "received" and "enjoyed"?

Mr. Harris (Minister of Finance): I have only a layman's knowledge of this matter. These words have been part of the act for some time. I think "received" and "enjoyed" are synonymous terms that have been part of the taxing statute since I have known of it. But I will look up the definition in order to see whether there is anything unusual in it. 93/

"...IN RESPECT OF, IN THE COURSE OF, OR BY VIRTUE OF THE OFFICE OR EMPLOYMENT"

Only the value of benefits received or enjoyed "in respect of, in the course of, or by virtue of" an office or employment is required to be brought into income by section 5(1)(a). The courts have not yet come to grips with the problem of interpreting these phrases, and it is not clear whether they were intended by Parliament to have the same connotation, being simply alternative forms of expression, or whether each phrase was intended to have

a separate meaning, and if so, what meaning. There seems to be little difference in meaning between "in respect of" and "by virtue of", and indeed these terms have been used synonymously by English judges interpreting the English Income Tax Acts. 94/ The expression "in the course of" appears to convey the idea of "during the continuance of" and, if this interpretation is accurate, is probably narrower in scope than either of the other phrases, for a benefit received after the termination of an office or employment 95/ might be taxable as having been received or enjoyed "in respect of" or "by virtue of" but not likely "in the course of" the office or employment.

In Williams v. M.N.R. the Exchequer Court did not differentiate between these terms and held simply that "...the board and lodging which the appellant received or enjoyed was so received or enjoyed by him 'in respect of, in the course of or by virtue of' his employment"...96/ Two reasons were given by Cameron J. for this conclusion. First, "Had he not been employed by the company, he would not have been entitled to and would not have received or enjoyed the benefits of the board and lodging"; 97/ and secondly, the agreement between the appellant and his employer contained a provision that the board and lodging were supplied "...in consideration of...services to be duly performed..." In view of the paucity of authority on this subject, each of these reasons merits a detailed examination.

It is true that in the circumstances of the case, the appellant would not have received the board and lodging furnished by his employer in accordance with the provisions of the Canada Shipping Act if he had not been engaged as a member of the crew. However, the "but for the employment" test can hardly be regarded as a conclusive test in view of the Canadian and English decisions which have held that benefits that would not have been received by an employee but for his employment were not taxable. 98/

In the leading Canadian case Goldman v. M.N.R., Rand J. said:

Contrasted with such a payment [a payment for services rendered] is a benefaction of an exceptional kind such as a **testimonial** or other personal tribute, the antecedent instigation of which has been an office or employment. There the essential elements of gift are present; and though it may be related to the fact of services, it is not as remuneration for them that the gift is attributed. 99/

In the recent decision of the House of Lords in Hochstrasser v. Mayes, 100/ an employee of a company received a payment from his employer in accordance with the terms of a housing agreement entered into by the company and the employee, which payment the Crown sought to tax. Lord Radcliffe pointed out that: "...while it is not sufficient to render a payment assessable that an employee would not have received it unless he had been an employee, it is assessable if it has been paid to him in return for acting as or being an employee." 101/ Lord Cohen expressed a similar view when he said "...it is not enough for the Crown to establish that the employee would not have received the sum on which tax is claimed had he not been an employee. The Court must be satisfied that the service agreement was the causa causans and not merely the causa sine qua non of the receipt of the profit". 102/ Hence, while it may be true that a benefit completely unconnected with the recipient's employment would not be taxable under section 5(1)(a), it seems clear from these authorities that the converse proposition is not true; the fact that a benefit would not have been received "but for" the recipient's employment is not enough to require its inclusion in his income.

There can be little quarrel with Cameron J.'s second reason for holding the value of the board and lodging taxable in the Williams case. A benefit conferred on an employee by his employer, pursuant to a contractual

obligation, as remuneration for services rendered is one of the clearest examples of income. Indeed, Parliament may well have intended the words "in respect of, in the course of, or by virtue of the office or employment" to include only benefits conferred as remuneration for services, to the exclusion of benefits granted on grounds personal to the recipient, such as testimonials, birthday and wedding gifts, and benefits inspired by motives of charity or compassion or the like. It is most unlikely that section 5(1)(a) was intended to do away with the distinction between a personal gift and remuneration which was recognized as a part of Canadian tax law by the Supreme Court of Canada in Goldman v. M.N.R., 103/ a case arising under the Income War Tax Act. However, as was noted earlier, Information Bulletin No. 24 calls for the inclusion of gifts in income. 104/

It is to be observed that the courts have not restricted the concept of "remuneration for services" to payments directly rewarding an employee for certain work, but have included within it certain benefits enjoyed by a taxpayer in his capacity as employee, such as benefits conferred as an inducement or incentive to take a more active interest in his employer's business or to apply himself energetically and give good service in the future. In No. 126 v. M.N.R., 105/ shares were sold by a company to certain of its senior key officials in order to strengthen their interest in its affairs and make them feel that they were part of the corporation. The difference between the price paid by the purchasers and the current market price of the shares was held taxable as a benefit under sections 5(1)(a) and 8(1)(c). 106/

On the other hand, a payment made by an employer to an employee to reimburse him for the loss suffered on the sale of his home, which sale was

occasioned by his transfer to another part of the country, was held by the House of Lords in Hochstrasser v. Mayes 107/ not to constitute remuneration for services and, hence, was not taxable as a profit "from" his employment. The taxpayer was employed by Imperial Chemical Industries Ltd., which owned numerous factories in different places and employed a large number of staff, many of whom were obliged by their service agreements to be prepared to serve the employer wherever required. In order to facilitate the transfer of certain of its staff, the employer designed a scheme which provided that if on transfer the employee wished to sell or rent his house, he was to give an option to the employer to purchase it at a fair valuation; if the option was refused, he was free to sell it, but in either case the employer guaranteed him against any capital loss. In 1951, the respondent entered into an agreement with his employer pursuant to the housing scheme. On his transfer to another factory in 1954, he sold his house with the consent of the employer at a loss of £350, which sum it paid him as compensation for the loss.

The House of Lords held unanimously that the payment was not received as remuneration for services. In Lord Radcliffe's opinion, the source of the payment was the housing agreement, and the circumstance that brought about his entitlement to the money was not any services given by him, but his "personal embarrassment in having sold his house for a smaller sum than he had given for it...such a payment is no more taxable as a profit from his employment than would be a payment out of a provident or distress fund set up by an employer for the benefit of employees whose personal circumstances might justify assistance". 108/ Lord Cohen put the matter thus: "...the housing scheme pursuant to which the housing agreement was made was introduced by I.C.I., not to provide increased remuneration for employees, but as part

of a general staff policy to secure a contented staff and to ease the minds of employees compelled to move from one part of the country to another as the result of the company's action". 109/

Although such a payment would seem clearly to be a "benefit" within the meaning of section 5(1)(a) of the Canadian Income Tax Act—indeed, Lord Radcliffe said that he regarded the payment "as being in substance a free benefit" conceded to the employee—nevertheless, the payment would not be taxable, on the basis of the reasoning of the House of Lords, if the words "in respect of, in the course of, or by virtue of the office or employment" include only benefits conferred as remuneration for services. However, as was pointed out earlier, the precise scope of these words awaits judicial determination.

EXEMPT BENEFITS

Section 5(1)(a) of the Income Tax Act provides for the exclusion from income of an employee of the benefit he derives from his employer's contributions to or under

- (a) a registered pension fund or plan
- (b) group sickness or accident insurance plan
- (c) medical services plan
- (d) supplementary unemployment benefit plan
- (e) deferred profit sharing plan, or
- (f) group term life insurance policy.

These benefits will be considered seriatim.

Registered Pension Fund or Plan

The Income War Tax Act contained no express provision exempting from the income of an employee the benefit derived by him from contributions made on his behalf by his employer into a superannuation or pension fund, in the year of payment into the fund. Nevertheless, such contributions "...at least

until they emerge as pensions, are not treated as taxable income in the hands of the employee". 110/

An exemption for the benefit derived by an employee from his employer's contribution to or under "an approved superannuation fund or plan" was contained in section 5(a) of The 1948 Income Tax Act; a similar provision appears in section 5(1)(a) of the Income Tax Act, 1952. Presumably this exemption was motivated by considerations similar to those which led to the enactment of the deferred profit sharing plan provisions in 1960, as explained by the then Minister of Finance, the Honourable Donald Fleming:

Here, with a view to encouraging employers to share profits and also to set them aside in a plan that will provide benefits to the employee at the time of retirement, we do not propose to tax the employee in respect of those contributions made on his behalf by the employer into the fund and we propose to allow the employer to deduct up to \$1,500 per employee the contribution that he makes into the fund on behalf of that employee. These are benefits that are extended to both employer and employee in order to encourage employers to make this kind of provision for employees under proper plans, with proper trust provisions, these plans to be registered according to rules with the Minister of National Revenue, in order that there may be something available to these employees at the time of retirement. 111/

In 1956, the words "a registered pension" were substituted for "an approved superannuation". 112/ The reason for the amendment was explained by the then Minister of Finance, the Honourable Walter Harris:

...the change of the wording to "registered pension" is to overcome the misunderstanding which I think has arisen over the use of the word "approved" in the present act. We do not approve pension plans as such. All that the Department of National Revenue does is to register pension plans whereunder the employer may be entitled to deduct certain payments made into the fund for income tax purposes. On the other hand, the use of the word "approved" would indicate that we had in some manner indicated approval of the plan itself, and we are trying to avoid that in what we are doing here. 113/

Although only the benefit derived from contributions to a registered pension fund or plan (formerly, approved superannuation fund or plan) is explicitly exempted, the Tax Appeal Board held in Pazuk v. M.N.R. 114/ that an employee was not taxable in respect of contributions made by his employer into a non-approved fund because the employee neither received nor enjoyed any benefit from those contributions in the year they were made, and hence did not fall within the terms of section 5(1)(a). The Pazuk case is discussed supra.

Group Sickness or Accident Insurance Plan

As originally enacted in section 5(a) of The 1948 Income Tax Act the exemption read "group insurance plan". The words "life, sickness or accident" preceding the words "insurance plan" were added in 1959. 115/ The reason for the amendment was explained by the Minister of Finance as follows:

Mr. Fleming:...This addition is necessary because of the detailed amendment which follows in clause 2 with respect to group life insurance. Without these qualifying words, the words "group insurance" could cover any kind of insurance purchased by a group. This provision which will follow in clause 2 of the bill is confined to group life insurance. 116/

The provision dealing with group life insurance is discussed infra.

It is worth noting that (i) the employer's contribution is probably deductible as an ordinary operating expense, (ii) the benefit derived by the employee from the employer's contribution is specifically exempted from taxation and (iii) amounts paid under the plan for the employee's benefit are not likely taxable under section 5(1)(a) since they are not received or enjoyed "in respect of, in the course of, or by virtue of the office or

employment", nor do they fall to be taxed under any other provision. Thus, the benefit to the employee escapes tax completely.

Medical Services Plan

This exemption was granted in section 5(a) of The 1948 Income Tax Act. Here again (i) the employer's contribution to, say, a Blue Cross Plan or Medical Services Plan is probably deductible as an ordinary operating expense, (ii) the benefit to the employee from the employer's contribution is specifically exempted, and (iii) when the employee receives a benefit under the plan (that is, when his hospital or medical bill is paid), he is not taxed on the amount of the benefit. Moreover, the employee is entitled to include payments made on his behalf pursuant to a private hospitalization plan, as distinguished from a government hospital insurance plan, in computing his medical expense deduction.

According to a recent ruling by the Department of National Revenue, that portion of the premium paid by an employer on behalf of an employee in respect of a government hospital insurance plan must be included in the employee's income. 117/

Supplementary Unemployment Benefit Plan

This exemption was added to section 5(1)(a) in 1956. 118/ A supplementary unemployment benefit plan is defined in section 79A(1) of the

Income Tax Act to mean

...an arrangement, other than an arrangement in the nature of a superannuation or pension fund or plan or an employees profit sharing plan, under which payments are made by an employer to a trustee in trust exclusively for the payment of periodic amounts to employees or former employees of the employer who are or may be laid off for any temporary or indefinite period.

One commentator has likened it to a guaranteed annual wage. 119/

The employer's contribution to a supplementary unemployment benefit plan is deductible (sections 11(1)(s) and 79A(4)), the income of the trust is tax free (section 79A(2)) and the amounts received by an employee from the plan are taxable (sections 6(1)(m) and 79A(3)).

Deferred Profit Sharing Plan

This exemption was added to section 5(1)(a) in 1961, 120/ when section 79C, governing the taxation of parties to deferred profit sharing plans, was enacted to encourage individuals to provide security in old age by way of profit sharing plans. In the words of the Honourable Donald Fleming, the then Minister of Finance:

Under this measure the contribution of the employer on behalf of the employees to such a plan is given exemption in relation to the employer's income. The benefit that will be payable to the employee on retirement—and this is the purpose of the deferment that is contemplated in the deferred profit sharing plan—will be taxable like any other income at that time.... We think there is a great deal of social benefit in such plans and that the Income Tax Act should be so revised now as to encourage employers to establish such plans so their employees may benefit substantially at the time of retirement. 121/

In answer to a question, Mr. Fleming affirmed that, under current law, an employee was taxable in respect of the benefit he derived from his employer's contribution to a deferred profit sharing plan on his behalf at the time the contribution was made, even though the employee did not receive any cash. Under the measure he was proposing, the treatment of this employee would be quite different:

The purpose of the deferred profit sharing plan is to relieve him [the employee] of any tax in respect of contributions made into the deferred profit sharing plan by his employer on his behalf. He is not going to be taxed on those while

they are in the plan and accumulating there. When he takes them out on retirement, then under this clause they will be taxable. 122/

Hence, the provision in section 5(1)(a) exempting from the income of an employee "...the benefit he derives from his employer's contributions to or under a...deferred profit sharing plan".

The general scheme of the elaborate provisions governing deferred profit sharing plans is that (i) an employer may deduct from his income the aggregate of his payments into the trust up to a maximum of \$1,500 per employee less the amount paid on behalf of that employee into a registered pension fund or plan; (ii) the income of the trust is exempt, provided certain provisions are met, and (iii) amounts received by a beneficiary under the plan are includible in the income in the year of receipt with certain exceptions.

Group Term Life Insurance Policy

In The 1948 Income Tax Act, an exemption was granted in respect of the benefit derived by an employee from his employer's contribution to or under "a group insurance plan".

In 1959, the expression "group life, sickness or accident insurance plan" was substituted for "group insurance plan". 123/ Also, in 1959, section 6(1)(db) was enacted to require the inclusion in income of that portion of the premium for any excess over \$25,000 of the amount of life insurance in effect on the life of a taxpayer under a group policy. The reason for the enactment of this provision was given by the Minister of Finance, Mr. Fleming:

There has been an increasing use of group life insurance plans as a means whereby corporations provide substantial remuneration to some of their senior officers in a tax-free form. This is unfair to other taxpayers. 124/

The Minister explained the method of taxing the benefit as follows:

How are you going to tax such a person in respect of the premium on the excess over \$25,000?....One could go about it in two ways, broadly speaking. One could say: we will regard as income in the hands of such a man the premium which he would pay at his age on that particular policy according to its amount and its provisions. But that might not be fair, because the man might be advanced in age; he might, indeed, have reached a point where insurance premiums are very heavy. He might even have passed the point where he can obtain insurance on an individual policy. What we have done, therefore, is, in effect, to work out an average so that what such a man will have to pay is the average premium on the whole group under the group plan. 125/

In 1963, the words "group term life insurance policy" were inserted in place of the words "group life....insurance plan", in section 5(1)(a). 126/
The effect of the amendment is that the benefit derived by an employee from his employer's contributions under a group life insurance plan will be excluded from income only if the employer's contributions are to provide term insurance. The Minister of Finance, the Honourable Walter Gordon, explained the need for the amendment as follows:

It has been intended in the past that this exemption from income would apply only for term insurance and generally this has been the kind of insurance provided under employees group life insurance plans. However, recently there have been indications that some employers were arranging to provide a few key employees with substantial tax-free benefits in the form of permanent type life insurance policies with cash surrender values. This amendment is intended to make sure that this kind of benefit does not go tax-free. 127/

Section 6(1)(db) was also amended in 1963 to add the words "term life", so that it now requires the inclusion in income of the premium paid for any

excess over \$25,000 of life insurance on the life of the taxpayer under a "group term life insurance policy". Section 139(1)(sb) 128/ was enacted in 1963 and defines the expression "group term life insurance policy" to mean "...a group life insurance policy under which no amount is payable as a result of the contributions made to or under the policy by the employer of the taxpayer except in the event of the death or disability of the taxpayer".

In their submissions to the Royal Commission on Taxation, Imperial Oil Limited and the Canadian Institute of Chartered Accountants were critical of section 6(1)(db) on the ground that in determining whether any employee has group life coverage in excess of \$25,000 it is necessary to include policies which may be fully paid for by employees. The comments of the Analysis of Research Division of the Royal Commission on Taxation on this point in the Imperial Oil Limited submission read as follows:

By requiring that policies fully paid for by employees be included in computing the \$25,000 figure, section 6(1)(db) in effect discriminates against such employees. Thus an employee may provide group insurance of \$15,000 paid for by himself and the employer provides \$15,000. Under the formula roughly $1/3$ of the premium paid by the employer is included in the employee's income, even though the coverage provided by the employer is only \$15,000. (The employee has already paid tax on the money he used to pay the premium on the \$15,000 furnished by himself.) On the other hand, where an employer provides the entire \$30,000 group coverage on an employee, the employee pays tax on the same amount, namely $1/6$ th of the total premium.

The Canadian Institute of Chartered Accountants recommended that group insurance coverage to the extent paid for by an employee should not be included in the \$25,000 limit.

ALLOWANCESIncome War Tax Act

Section 3(1)(e) of the Income War Tax Act provided for the inclusion in income of

(e) personal and living expenses when such form part of the profit, gain or remuneration of the taxpayer or the payment of such constitutes part of the gain, benefit or advantage accruing to the taxpayer under any estate, trust, contract, arrangement or power of appointment, irrespective of when created.

This provision was invoked by the Minister of National Revenue in the leading case of Samson v. M.N.R. 129/ to tax an employee in respect of a per diem living allowance. In that case, the appellant was appointed Hides and Leather Administrator of the Wartime Prices and Trade Board under an Order in Council which provided that he be paid a salary of \$1.00 per year, his actual transportation expenses, and a living allowance of \$20 per day while absent from his place of residence in connection with his duties. He was assessed in respect of the \$20 per day living allowance, less a deduction of \$2 per day, but was not charged in respect of the transportation expenses. It was not disputed that the taxpayer actually disbursed more than the amount of the allowance while absent from his place of residence and in connection with his duties. He kept no vouchers in respect of these expenditures, and did not produce itemized accounts of travelling expenses. Thorson P. held that the allowance was not taxable. It involved no element of remuneration or net gain or profit or gratuity to the appellant, he said, and did not result in any gain or profit to him, but was paid and received only as reimbursement to the appellant of living expenses over and above ordinary personal and living expenses to which he would be put by reason of

his necessary absences from his residence in connection with his duties.

His Lordship acknowledged that, in some circumstances, an allowance would be taxable:

It may well be that an arrangement made between individuals under which a fixed amount is paid for certain expense purposes may result in net gain or profit to the recipient of the fixed amount through his actually spending less than the fixed amount on such expenses and the recipient may be properly assessable for income tax in respect of such net gain or profit in that it becomes remuneration to him.... 130/

But such was not the case here where the Order in Council made it clear that the essential character of the payment was reimbursement. He went on to point out that the assessability for income tax purposes of any particular amount did not depend upon what it was called, but rather upon what it really was:

...the use of the word "allowance", whether in a statute or otherwise, does not of itself determine whether the amount of it is solely reimbursement of expense or whether it may have implications of remuneration. It is clear that in many cases the provision of an allowance, having regard to all the attendant circumstances, is in reality the payment of remuneration in respect of which the recipient is properly assessable for income tax purposes. The test is not merely that the amount is fixed. No such easy determination is possible, however convenient it may be for administrative purpose. In each case the true nature of the amount, by whatever name it may be described, must be determined. 131/

This decision may be explained on the basis of the doctrine of beneficial receipt, according to which an amount received by a taxpayer will have the quality of income only if his right to it is absolute and under no restriction, contractual or otherwise, as to its disposition, use or enjoyment. 132/

As one writer has pointed out,

...where cash is supplied to an employee who is under a duty to apply it according to his employer's needs and objects it is not income of the employee.

There is no difference in principle where an employee is required to spend his own money in this manner and is reimbursed at a later date. 133/

In order to overcome the decision in the Samson case, Parliament enacted section 3(4) of the Income War Tax Act which taxed as income any payment made to any person in connection with a duty, office, or employment, but which specifically excluded from its operation travelling expenses and living allowances paid to certain categories of persons employed by the federal government. Section 3(4) provided as follows:

Any payment made to any person in connection with any duty, office or employment, whether as allowances on a per diem or other periodic basis, living allowances or expenses or otherwise, except

- (a) travelling or other allowances expressly fixed by and in any Act of the Parliament of Canada,
- (b) travelling expenses and separation allowances designated by the Minister, paid to a member of the permanent Canadian Naval, Military and Air forces who is in receipt of pay and allowances at rates designated by the Minister as new permanent force rates of pay and allowances, and
- (c) travelling expenses paid to any member of the Canadian Naval, Military or Air forces in the Canadian Active Service Forces other than to a member of the permanent Canadian Naval, Military or Air forces described in paragraph (b) of this subsection,

shall be salary of such person and taxable as income for the purposes of this Act: Provided, however, that living allowances paid to persons who are serving outside of Canada but are maintaining a self-contained domestic establishment in Canada and who are either employees of the Government of Canada or members of the Canadian Naval, Military or Air forces in the Canadian Active Service Forces shall not be deemed to be taxable income up to such an amount as may be determined by the Minister in his discretion. 134/

This provision was consistently invoked with success by the Minister of National Revenue in taxing a wide variety of "allowances", 135/ a term which

was not defined in the Act. The scope of the provision was perhaps best expressed by the Chairman of the Income Tax Appeal Board in Hawkins v. M.N.R. 136/ The appellant, a public health nurse, was paid \$840 as an allowance to take care of the estimated cost to her for the use of her own car in carrying out her duties, which amount she did not include as income in her tax return. The appellant established that she paid out for gas, oil, and repairs and insurance a total of \$454.50, and estimated the depreciation on her car at \$472.75. Mr. R. T. Graham held that by virtue of sections 3(4) and 6(6) of the Income War Tax Act, the allowance constituted income, but that the expenses were not deductible:

I agree with her that it appears unfair that she would be taxed on the sum of \$840 without regard to the monies actually expended by her in the carrying out of her duties in the very useful occupation of a public health nurse. Nevertheless, I find that under the provisions of the Income War Tax Act such an amount is declared to be salary and taxable as income in the year in which it was received....

The arrangement between the appellant and her employer undoubtedly provides for the payment of her car expenses by an allowance on a periodic basis and this, in my opinion, brings it within the provisions of section 3(4).

...I am of the opinion that Parliament intended that any allowance for expenses on a periodic basis as opposed to reimbursement for actual out of pocket expenses is covered by the subsection....

The appellant is also met by the provisions of subsection (6) of section 6....The appellant does not come within the exceptions provided for in the subsection and it is clear, therefore, that no amount is deductible from her income for a disbursement or expense laid out for the purpose of earning the income. 137/

With respect to the deduction of expenses, the Income Tax Appeal Board intimated in other decisions that, if the taxpayer had been able to produce vouchers or other evidence, he could have deducted the expenses claimed. 138/

Income Tax Act

INTRODUCTION

Section 5(1)(b) of the Income Tax Act contains provisions similar to those found in section 3(4) of the Income War Tax Act, but in even more sweeping language, though with more exceptions. It requires a taxpayer to include in his income from an office or employment "all amounts received by him in the year as an allowance for personal or living expenses or as an allowance for any other purpose...." Exceptions are set out in paragraphs (i) to (viii) of section 5(1)(b) and in section 5(2), dealing with construction workers, and in section 10(2) and (3), dealing with expense allowances of members of provincial legislatures and municipal officers, respectively. All of these exceptions will be considered below. The scheme of the legislation thus appears to be to require the inclusion in income of all allowances with certain stipulated exceptions, and to permit such deductions as Parliament has considered appropriate and for which it has made specific provision in section 11.

MEANING OF ALLOWANCE

The term "allowance" is not defined in the Income Tax Act nor has its breadth of meaning been clearly marked out in the handful of decisions in which payments have been sought to be taxed as allowances. The dictionary definitions are of limited assistance. Funk and Wagnall's New Standard Dictionary of the English Language, 1961, defines "allowance" as:

1. That which is allowed; a portion or amount granted for some purpose, as by custom, military regulation, operation of law, or judicial decree; also, a limited amount or portion, as of income, or food; as, an allowance of rations, an allowance for tare or breakage; to put one on an allowance of bread.

And according to the Shorter Oxford Dictionary, (3rd ed.) p. 47, "allowance" means:

2. The action of placing to one's credit, admitting in an account, or allotting on account of expenses...; a sum allowed in account, a consideration.... 3. A limited portion or sum, esp. of money or food.... 4. Rebate, deduction, discount....

Some guidance is provided by a few Australian decisions interpreting section 26(e) of the Income Tax and Social Services Contribution Assessment Act, 1936-1963, which provides for the inclusion in the assessable income of a taxpayer of "the value to the taxpayer of all allowances, gratuities, compensations, benefits, bonuses and premiums allowed, given or granted to him in respect of, or for or in relation directly or indirectly to, any employment of or services rendered by him...." The effect of the cases is succinctly stated as follows:

In a decision under the Pay-roll Tax Assessment Act 1941, the Board of Review, 10 C.T.B.R. Case 153, at p. 483] in considering the meaning of the word "allowance", referred to the extent to which it was used in industrial and arbitration awards and the wide meanings attributed to it. In many instances, allowances awarded were in the nature of extra remuneration "for work performed under exceeding difficulty or unpleasant conditions" but the word was mostly used to describe additional payments "not having the character of remuneration...to compensate the employees concerned for the additional expenses which, from time to time, may be incurred by them in carrying out their duties." The Board then referred to the distinction between an allowance and a reimbursement and stated:-

"A reimbursement transfers from the employee to the employer the burden of expenses actually incurred in the course of the employment. An allowance is designed to compensate the employee because the employer does not wish to be under the obligation of meeting such expenses directly or indirectly."

It seems clear, therefore, that where expenses are reimbursed, the amount of the reimbursement is not an "allowance" within the meaning of s. 26(e). On the other hand it seems, that, in some instances, the amount of the reimbursement may be a "benefit" within the meaning of the same section. Thus, in 12 C.T.B.R. Case 14, p. 106, where an assistant manager of

the company was appointed general manager in another State and the company reimbursed him in respect of £421, being expenditures incurred by him in renting a house in the other State, the arrangement being one of the terms on which he accepted the position of general manager, the Board stated that if the rent under notice had not been reimbursed, the taxpayer would have been in a less favourable position and that the amount of the reimbursement was a benefit to him within the meaning of s. 26(e) and, therefore, assessable. On the other hand, in (1951) 2 T.B.R.D. Case B55, p. 227, the Board of Review held that the reimbursement of money spent by an employee out of his own pocket on such things as refreshments for his employer's staff when they were working overtime, on entertaining agents of the business and people he wished to make agents and on buying small items for the business was not within the scope of s. 26(e). 139/

In the last-mentioned decision, Case B55, the Court was of the opinion that when the taxpayer, acting within the scope of his authority as manager of his employer's business, spent his own money on behalf of his employer, the latter became liable to reimburse him, and monies paid to discharge that liability and recoup the taxpayer were not income within the ordinary meaning of that term, nor did they constitute "an allowance" within section 26(e). By a parity of reasoning, a reimbursement does not likely fall within the scope of "allowance" in section 5(1)(b).

Since different arrangements between an employer and an employee for meeting the burden of certain business expenses will give rise to varying tax consequences for the employee, a premium is placed on tax planning. Consider, for example, the various ways in which customers and clients may be entertained on behalf of a business, and their tax consequences to the employee.

(a) If an employee, for business purposes, took customers to dinner at a restaurant and charged the bill to his employer's account, the employee would not be taxable in respect of the outlay, except, perhaps, in respect

of the value of the food and drink and entertainment for himself, which might be taxable under section 5(1)(a) as a "benefit".

(b) If an employee, for business purposes, took customers to dinner at a restaurant and paid the bill himself, and was later reimbursed by his employer, he would not likely be taxable on the payment, since the employer would simply be recouping or indemnifying the employee for monies expended by him on his employer's behalf. See Hawkins v. M.N.R. supra, p. 90, and the extract from Challenor and Greenwood, Income Tax Law and Practice (Commonwealth), supra, pp. 92 and 93, where a reimbursement is distinguished from an allowance. Of course, if the expense was incurred for the personal benefit of the employee and not for business purposes, the reimbursement would doubtless be taxable under section 5(1) as remuneration or as a "benefit".

The burden of establishing the purpose for which the amount in respect of which reimbursement is made rests on the taxpayer. Thus, in Cotnam v. M.N.R. the Minister contended, inter alia, that the appellant, who was an officer and employee of a company, had not produced sufficient evidence to show that certain sums expended by him, for which he was reimbursed by the company, were amounts expended for the purpose of gaining or producing the company's income and that such amounts, therefore, became income to the appellant from his office or employment in accordance with section 5(1) of the Income Tax Act. It was held that:

Such records as were kept by Mr. Cotnam in 1960 did not satisfy the onus which always rests on the appellant to sustain the contention that the Minister was wrong in his computation of the net income of the appellant for the year 1960. The evidence falls short of showing such essential facts as would justify interference with the revised assessment made against the appellant. 140/

(c) If an employee received payments periodically, say, each month, for the purpose of meeting entertainment expenses on behalf of his employer, for which payments he was required to account to his employer, it is unlikely that the employee would be assessable in respect of these payments which he received as agent or trustee for his employer and which he dispensed in pursuit of employer objectives, although there appears to be no Canadian decision on the point. Again, to the extent that these funds were expended for the employee's own personal benefit, they would be includible in his income as remuneration or as a benefit.

(d) Finally, if an employee received periodic payments for the purpose of entertaining customers and clients, for which payments he was not obliged to account to his employer, he would very likely be required to include the payments in his income under section 5(1)(b) as "an allowance... for any other purpose", even though he expended the payments in pursuit of employer business objectives and even though he could not bring the expenses within any of the deductions permitted by section 5, so that, in effect, he would be taxed on the gross amount of the payments. However, judicial opinion is not unanimous on this result.

The one case favouring the taxpayer is Bherer v. M.N.R. 141/ where the appellant received, in addition to a salary, \$2,000 as entertainment and travelling expenses as chairman of the Catholic School Commission of Quebec. The Minister, in assessing the appellant for the years 1958 and 1959, added the allowance to his income, on the ground that it was taxable as income and did not fall within the exemptions in section 5(1). The appellant contended that the expenses were paid to him and expended by him for the purposes of the Commission and not for his own purposes and,

therefore, they were allowances which, although received, were not enjoyed by him within the meaning of section 5(1). Mr. Boisvert held that, although the appellant was not covered by the exceptions in section 5(1), there was neither gain nor profit to him from the expenses paid, and so they were not includible in the year's income. The following passage reveals his interpretation of section 5(1)(b):

All that a taxpayer receives is not always taxable income. A capital gain, for example, is not taxable income. In the present case the appellant received two amounts that he cannot enjoy himself but must use or spend in the carrying out of duties and obligations the Commission cannot itself perform.... The sums paid to the Chairman were paid to him for the needs and purposes of the Commission and not for the appellant's personal needs and purposes. It was a benefit he received but did not enjoy himself. If he could not enjoy it, it follows that it is not income, for income is something which is received to be disposed of for oneself and to suit oneself. Then, if you wish to call the above amounts "allowances", they must be of such a nature as to provide some personal property or pecuniary advantage which will become part of the taxpayer's assets. What the appellant received was paid to him for the purpose of carrying out the Commission's business; it added nothing to his fortune. What he collects from one he hands out to others in discharging the duties of his office. Since it is not stated anywhere in the Act that what a taxpayer receives to be used for particular and clearly defined purposes is income, I fail to see how amounts received and spent could be regarded as taxable income. It was not the intention of the legislator that a taxpayer should be taxed on the amounts allowed him to be spent in accordance with the law or with an agreement determining what he must do in order to receive what is thus allowed him. The appellant proved, without being contradicted, that he had actually spent the amounts received by him during the years 1958 and 1959, that he had spent them as entertainment and travelling expenses in the performance of his duties as Chairman of the Commission and that he had nothing left out of those amounts in his own right. Of course, if the appellant had collected those amounts and converted them to his own use, for his own purposes, using them just as he did his salary, it could be claimed, and rightly so, that the said benefits and allowances were concealed payments or benefits in disguise, which the parties intended to be added to the appellant's salary. Then the Minister might be justified in claiming that Section 5 of the Act would apply. But such is not the case here. The amounts received by the appellant were used for the exact purposes for which they were intended. 142/

Mr. Boisvert quoted with approval from the decision of Thorson, P. in Samson v. M.N.R., but made no mention of the fact that section 3(4) of the Income War Tax Act was enacted shortly after the decision in the Samson case in order to overcome its effect by requiring the inclusion in income of all allowances, with certain specified exceptions, the same scheme as is followed in section 5(1)(b) of the Income Tax Act. Moreover, if the reasoning is correct, certain of the exceptions in section 5(1)(b) become superfluous—for example, paragraph (vi) which exempts "reasonable allowances received by a minister or clergyman in charge of or ministering to a diocese, parish or congregation for expenses for transportation incident to the discharge of the duties of his office or employment...." The Minister has appealed the decision in Bherer v. M.N.R. to the Exchequer Court.

On the other hand, consider the following decisions which have required the inclusion of allowances in the computation of income. In Campbell v. M.N.R. 143/ the taxpayer was superintendant of nurses at a hospital for chronic invalids. Many of the patients had to be taken to a general hospital for treatment, and since the hospital maintained no transportation service of its own, she used her own car for this purpose, and also for carrying out other duties on behalf of her employer, such as obtaining maintenance supplies and taking deposits to the bank. In consideration for using her car for her employer's business, she was paid a monthly consideration which the Minister assessed as a taxable allowance under section 3(4) of the Income War Tax Act, for the year 1948, and under section 5(b) of The 1948 Income Tax Act for the years 1949 to 1951, both inclusive. The taxpayer paid for the gas and oil and repairs to the automobile. Mr. Fisher held that the monthly payments received by her for the use of her automobile were properly assessed as income in her hands "as an

allowance paid to her by her employer on a periodic basis and without allowing any deductions in respect of the expenses incurred in running and maintaining the said automobile". 144/ Thus, she was taxed on the gross amount of the allowance. If she had incurred these expenses herself, and then claimed reimbursement for them, it is doubtful whether she would have been taxable on the payment.

More recently, in M.N.R. v. Pelletier 145/ the taxpayer, an internationally known musician and a resident of New York, was a director of the Quebec Conservatory of Music, with headquarters in Montreal. As director, he was paid \$5,500 per year, plus a travelling allowance of \$2,000 for which he was not obliged to render account. In reporting his income for 1955, 1956 and 1957, he did not include the travelling allowance. It was held by Dumoulin J. that the taxpayer was a permanent employee of the Province of Quebec, and was obliged to include the travelling allowance in his income under section 5(1)(b):

Disons de suite que l'article 5 de la Loi de l'impôt sur le revenu interdisait pareille omission au contribuable....

His Lordship did not inquire as to whether the money was in fact expended in performing the duties of his employment or whether the taxpayer benefited personally.

Other cases in which allowances have been held to be taxable under section 5(1)(b) are considered below.

TAXABLE ALLOWANCES

Section 5(1)(b) requires the inclusion in income from an office or employment of all amounts received as "an allowance for personal or living

expenses or as an allowance for any other purpose". [Emphasis added.] The expression "personal or living expenses" is of broad scope and is only partially defined in section 139(1)(ae) to include:

- (i) the expenses of properties maintained by any person for the use or benefit of the taxpayer or any person connected with the taxpayer by blood relationship, marriage or adoption, and not maintained in connection with a business carried on for profit or with a reasonable expectation of profit,
- (ii) the expenses, premiums or other costs of a policy of insurance, annuity contract or other like contract if the proceeds of the policy or contract are payable to or for the benefit of the taxpayer or a person connected with him by blood relationship, marriage or adoption, and
- (iii) expenses of properties maintained by a personal corporation, estate or trust for the benefit of the taxpayer as one of its shareholders or beneficiaries.

In cases in which allowances have been held to be includible in income, the courts have not indicated whether the amount in question fell to be taxed as an allowance "for personal or living expenses" or for "any other purpose". It is unlikely that the latter expression is limited by the ejusdem generis rule to allowances in the nature of personal and living expenses, although the point appears never to have been raised before the courts. Certainly the courts have not so interpreted these words, for while some allowances held to be taxable were in the nature of personal and living expenses (see, for example, Pelletier v. M.N.R., supra), others clearly were not (see, for example, Campbell v. M.N.R., supra). The Bherer case would include "allowances for any other purpose" in income only to the extent that the recipient benefited personally from the payments, but in this respect, it stands alone. 146/

EXEMPT ALLOWANCES

Section 5(1)(b) and (2) and section 10(2) and (3) provide for the exemption of certain allowances:

- (a) travelling or personal or living expense allowances expressly fixed in an Act of Parliament 147/ or paid under the authority of the Treasury Board to a person appointed pursuant to the Inquiries Act;
- (b) travelling and separation allowances received by a member of the armed forces of Canada;
- (c) special allowances received in respect of a period of absence from Canada by an ambassador, a servant of Canada or of a province, or a member of the armed forces of Canada;
- (d) special allowances received by an agent-general of a province in respect of a period while he was in Ottawa;
- (e) reasonable allowances for travelling expenses received by an employee from his employer in respect of a period when he was employed in connection with the selling of property or negotiating of contracts for his employer;
- (f) reasonable allowances received by a minister in charge of a diocese for expenses for transportation incident to the discharge of his duties;
- (g) allowances (not in excess of reasonable amounts) for travelling expenses received by an employee from his employer if they were computed by reference to time actually spent by the employee travelling away from (i) the municipality where the employer's establishment at which the employee ordinarily worked, was located, and (ii) the metropolitan area, if there is one, where that establishment was located, in the performance of his duties;

- (h) expense allowances received by a volunteer fireman from a public authority not exceeding \$300;
- (i) an allowance (not in excess of a reasonable amount) for board, lodging and transportation received under certain circumstances by construction workers engaged on out-of-town jobs;
- (j) an expense allowance received by a member of a provincial legislative assembly not exceeding half of his sessional indemnity; and
- (k) an expense allowance received by an elected officer of an incorporated municipality, not exceeding half of his remuneration.

It has been pointed out by one commentator that "...the Act exempts 'reasonable allowances' (section 5(1)(b)(v)), 'allowances (not in excess of reasonable amounts)' (section 5(1)(b)(vii)) or 'an allowance (not in excess of a reasonable amount)' (section 5(2)). It does not exempt the allowance to the extent that it is unreasonable. It would therefore appear that an unreasonable allowance is wholly taxable". 148/ By way of contrast, subsections (2) and (3) of section 10, which provide for the exemption of expense allowances received by members of provincial legislative assemblies and municipal officers, respectively, state that there shall be included in computing the recipient's income only the amount by which the expense allowance exceeds a stipulated amount.

It may be noted in passing that salesmen and other employees who receive exempt allowances are more restricted in the deductions which they may take under subsections (6), (9) and (11) of section 11.

FOREIGN TAX TREATMENT OF BENEFITS AND ALLOWANCES

United Kingdom

BENEFITS IN KIND

In accordance with the decision of the House of Lords in Tennant v. Smith, discussed supra, the general rule in the United Kingdom is that benefits in kind are not taxable unless they are convertible into money. Hence, an employee is not taxable in respect of free meals supplied by his employer which are available only for consumption and not resale.

The Royal Commission on the Taxation of Profits and Income was critical of the exclusion from income of inconvertible benefits:

No doubt an inconvertible benefit has not got a monetary value in exchange, but that does not seem to us to be the same thing as saying that it does not possess any value at all which should be taken into account in a computation of income. A man who receives remuneration of £1,000 in cash may well be said to have an income of a greater assessable value than another man who gets £700 in cash and the benefit of assigned living accommodation, even if the value of the latter is fairly put at £300. But we cannot accept that the true relation of their two incomes for the purpose of taxing them is correctly expressed in the proportion of 10:7. 149/

As regards free accommodation, this general rule that only convertible benefits are taxable has been substantially narrowed by the Finance Act, 1963, section 47, the effect of which has been succinctly described as follows:

For 1963-64 and subsequent years special provisions apply, which, although retaining the immunity of persons who live in premises for the purpose of performing their duties as employees, and so are not occupiers, widen considerably the liability of other employees. Where any premises are available to the occupier by reason of his or his wife's office or employment, and such person either pays no rent or pays less than the annual value, he is taxable on the

annual value of the premises reduced by the annual amount of any rent which he pays for them. This provision does not apply, however, if the rent payable was not, at the date when the tenancy was granted, less than might reasonably be expected to have been obtained (i.e., the then current market value), having regard to the terms of the tenancy, and if, at any subsequent time the landlord has the power (whether by terminating the tenancy or otherwise) to obtain a higher rent, the rent is not less than the then current value.

This statutory provision brings into charge many more cases than might be envisaged at first sight, because it is provided that where the occupier holds the premises under a tenancy from or by leave of the person from whom he or his wife holds an office or employment or any other person with whom that person is connected, the premises shall be conclusively presumed to be available to him by reason of his, or his wife's, holding the office or employment. A person is connected with another person in the same wide circumstances as are defined for the purposes of the short-term capital gains tax under Case VII of Schedule D and covers (*inter alia*) relatives, relatives of spouses, trustees, partners, connected companies, etc. The result is that a charge may arise where the occupation of the property has no real connection with the employment. A typical case would arise where a son occupies property rent free belonging to his father and is also employed by a family company which is 'connected' with his father. 150/

The principle that only money or benefits convertible into money may constitute income has not been consistently observed by the courts, and is quite irreconcilable with a number of decisions in which it has been held that the discharge of an employee's pecuniary obligation by his employer gives rise to a benefit in money's worth which forms part of the employee's income. For example, in Hartland v. Diggines the appellant's income tax was voluntarily paid each year by his employer. Viscount Cave, L. C. held: "It is true that the appellant did not receive cash in his hands, but he received money's worth year after year. This being so, I cannot resist the conclusion that the payment was in fact a part of his profits and emoluments as an officer of the company..." 151/ Although the taxpayer's pocket may have been saved an expense, it is not readily apparent what convertible benefit "came in". In Nicoll v. Austin 152/ a company of which the taxpayer

was a director entered into an agreement to pay him a salary and to defray certain expenses associated with the maintenance of his home: the cost of insurance and utilities, upkeep of the gardens and the repair of the house. It was held that the sums so paid to others were part of his income, on the ground that they constituted money's worth.

The inconsistency of the English decisions did not escape the attention of the Royal Commission which remarked:

...a taxable benefit arises whenever an employer discharges a pecuniary liability of an employee that he has not incurred in the course of performing the duties of his employment.... This rule cuts across the distinction between convertible and inconvertible benefits, since the payment of a particular bill for a man gives him no option between personal enjoyment and realisation. But any different rule would be contrary to common sense; and, presumably, the same difficulties of valuation do not occur as those that tend to defeat the assessment of the ordinary inconvertible benefit. 153/

As the Royal Commission pointed out, "Theoretically, all benefits in kind received in the course of employment and attributable to it are a form of remuneration and should rank as taxable income, since otherwise one taxpayer's income is not equitably balanced against another's". 154/ To a limited extent, the United Kingdom Parliament put this theory into practice, and thus pro tanto nullified the rule in Tennant v. Smith, by enacting special legislation in 1948 which provides for the taxation of directors of trading companies and employees whose gross remuneration (salary plus expense payments and benefits in kind) amounts to £2,000 per year, in respect of benefits in kind, convertible or inconvertible, received as remuneration. This legislation is considered below.

ALLOWANCES

An employee who incurs expenses on behalf of his employer is not

taxable on the payment made to him by way of reimbursement. "The clerk who is sent out to buy his employer's stamps, or the salesman who travels to another town to see a customer, are not taxable on the money paid to reimburse them. On the other hand, when the expenditure which is reimbursed is clearly for the benefit of the employee, the payment is treated as if it was remuneration. 155/ However, certain payments are specifically exempt from taxation:

- (a) An allowance to a Crown servant when certified by the Treasury to represent the extra cost of living abroad. 156/
- (b) An allowance to a member of the armed forces when certified by the Treasury to represent payment in lieu of food or drink normally supplied in kind, or as a contribution to a mess. 157/
- (c) An allowance in respect of certain removal expenses incurred by a change of employment; and
- (d) An allowance to members of the reserve and auxiliary forces of the Crown in respect of certain training expenses. 158/

Professor Wheatcroft points out that:

There are borderline cases where some benefit arises to the employee, although this is not the main purpose of the expenditure; the salesman who takes a customer to lunch at an expensive restaurant at his employer's expense is one common example. In general no attempt is made by the Revenue to assess the personal benefit when it is only subsidiary to the main purpose, particularly as in many cases the expenditure is paid for directly by the employer and the benefit is not convertible into cash so that it escapes tax on that ground. Another common case is that of the salesman who is provided with a car by his employer for business purposes and allowed to use it himself at weekends. It is not, however, possible to avoid tax by passing money to an employee and calling it "expenses" if it is not a genuine expense of the employer's

business; when such sums are paid they can only be justified to the extent that the employee can claim a deduction for them under the limited statutory rules next discussed.

Where, however, the employee is a director of a company or earning £2,000 per annum or more, there are special statutory rules which are equally applicable whether the expenditure is paid directly by the employer or incurred by the employee and reimbursed to him by his employer. 159/

SPECIAL LEGISLATION

The special legislation enacted by Parliament in 1948 to thwart tax avoidance through the use of benefits in kind and allowances is described by Professor Wheatcroft as follows:

Special statutory provisions apply to all directors of corporate bodies, whatever the amount of their emoluments, and to employees whose emoluments, when calculated in accordance with those provisions, amount to £2,000 a year or more. In computing the emoluments of an employee to see whether he comes within these provisions, the value of any benefits chargeable to him, if he is within the provisions, must be taken into account and no sum allowable to him for expenses may be deducted. When any such person receives a benefit in kind from his employer, which would otherwise not give rise to a charge under Schedule E (i.e., a benefit which is not convertible into cash), he is assessed to tax as if he had himself incurred the expenditure of providing that benefit and its amount had been refunded to him. Similarly if he receives a payment from his employer in respect of expenses then such payment is taxable as remuneration, subject to his right to claim such deduction as he would be entitled to had he incurred the expenditure himself. An employer is required to make special returns of all payments or benefits coming within these provisions, which are subject to P.A.Y.E.

Four types of benefit are expressly excluded from the charge under this rule, viz. (i) the provision, for the use solely of the director or employee in the performance of his duties, of any accommodation, supplies or services on any of the business premises of the employer; (ii) the provision, for an employee who is not a director, and who is required to live on the business premises, of living accommodation there, provided that this is either necessary for employees of that class because of the nature of their employer's trade or has commonly been provided for them in trades of that kind since before July 30, 1928; (iii) the provision of canteen meals which are provided for the staff generally; and (iv) the provision of benefits accruing on the death or retirement of a director or employee. To these four benefits must be added a fifth which is excluded by concession.

No tax is charged on the value of reasonable removal expenses, including a temporary subsistence allowance, borne by the employer on the occasion of a change of employment within the organisation, which requires the employee to change his place of residence.

Four cases show how extensive these provisions are. In one, a company thought it necessary that its export sales supervisor should live in London so as to be able to entertain customers; it took a flat there for him and his family to live in at a rent of £500 per annum and sublet it to him at £150 per annum. He was held taxable on the difference as an emolument of his employment. In the second a mill manager was required to live in a house near the mill and was provided by his employers with free coal, electricity and the cost of upkeep of his garden; he was similarly held taxable on these items. In two others a director occupied a house belonging to his company which was let to him at a rent and during his occupation the company spent substantial sums of money on repairs to the house. In each case the director was held to be taxable on the sums spent by the company.

These provisions are designed to prevent tax avoidance in relation to expense allowances and expense accounts; they are operated by the Revenue with some latitude, as, when strictly applied, they are widely regarded as a hindrance to legitimate business activity.

Benefits in kind are normally valued for the purpose of these provisions at the amount of their cost to the employer; but when an asset of the employer is transferred to the taxpayer, and has depreciated since its production or acquisition by the employer, tax is charged on the value of the asset at the time of the transfer. Where the taxpayer is allowed to use an asset which remains the property of his employer, he is charged on the annual value of the asset, or the annual rent or hire paid for its use by the employer, whichever is the greater, with the addition of any other expenses, such as rates, borne by the employer, in connection with the asset. Where the asset consists of premises in respect of which the employer is liable to be assessed under Schedule A, its annual value is taken to be equal to the Schedule A assessment as reduced for the purposes of collection. Otherwise the Act says nothing as to how the annual value of an asset is to be computed, but in the case of cars, the Chancellor of the Exchequer has directed that their annual value should normally be taken to be 12-1/2 per cent of cost when new.

In some cases where benefits in kind are provided, or payments on account of expenses are made to persons within these provisions, no additional tax will be paid because the amount of the charge will be exactly off-set by a deduction allowable according to the statutory provisions discussed later. In such cases the Revenue, acting on a statement furnished by the employer, may give notice that these provisions shall not apply in relation to the benefits or payments disclosed in the statement. Such a notice is called a 'dispensation' and may be revoked at any time. 160/

Although the Royal Commission recognized that the provision of non-taxable benefits in kind was capable of becoming an abuse of the tax system, it did not recommend a more comprehensive taxation of such benefits largely on the ground that "...the burden of administration would be so great that we do not regard an extension of the present law as justified unless the absolute loss of tax and the relative irregularities between different taxpayers are greater than we believe them to be.... It is not possible to obtain any figures that really bear upon the point." 161/

In summary, then, apart from the special legislation of 1948, which is applicable to directors and employees earning £2,000 a year or more, and the 1963 provision dealing with free accommodation, inconvertible benefits are not treated as taxable income in the United Kingdom.

United States

BENEFITS IN KIND

The general tax treatment of employee benefits in kind has been well described as follows:

a. IN GENERAL. The use of benefits in kind as wage and salary supplements has become increasingly widespread in recent years and has created a major issue of tax policy. These so-called fringe benefits may include meals and lodging furnished to employees at no cost, free medical services, health and accident insurance, discounts on merchandise purchased from the employer, recreational facilities, free parking spaces, bargain lunches, and, in some instances, free training and other educational opportunities.

As a practical matter, this type of noncash compensation has to a large extent escaped taxation. Although the scope of section 61 would appear to be broad enough to include most or all of such items in the tax base, and although the Regulations expressly state that "if services are paid for other than in money, the fair market value of the property...taken in payment must be included in income" (Regs. 1.61-2(d)(1)), the Internal Revenue Service has thus far made no full-scale effort to tax

the value of fringe benefits to the employee-recipients. The reasons are partly administrative. Since employees normally do not report the receipt of noncash benefits in their returns, the Service can only detect the existence of such benefits through extensive field audits. Further, the problem of valuing such benefits is sizeable and involves difficult conceptual questions; for example, if an employee receives free lodging which is better in quality than he would otherwise select, should he be taxed on the full fair market value thereof or should the value be discounted to reflect his normal living standards?

Issues relating to the definition of "income" for tax purposes have also been raised. Thus, it has been argued that noncash benefits should be excluded from the income definition on the ground that they represent nothing more than "conditions of employment," that is, mere working conditions having the same character as adequate lighting or safety devices. The employee does not have discretionary control over items of this kind—recreational facilities, for example—and cannot exchange them either for cash or for other goods or services. In effect, this view is founded on the idea that noncash benefits lack the normal incidents of compensation and therefore ought not to be treated as such. However, it has been pointed out that some noncash benefits, such as medical and group term insurance, are frequently granted by employers at the insistence of employees or their bargaining agents, often in lieu of wage increases. In addition, it seems clear that many types of noncash benefits—meals and lodging being the clearest examples, but certainly other forms of benefits, such as medical and group term insurance, as well—in effect relieve the employee of an expense which he would otherwise be obliged to meet out of his income after tax. The benefit thus represents a saving of personal expense which has a cash effect from the employee's standpoint. Further, even if it were conceded that the term "compensation" means, in common understanding, cash or its readily convertible equivalent, the meaning of "income" in section 61(a) is not so limited. Thus... the Supreme Court has stated that section 61(a) comprehends any economic benefit which constitutes an accession to the taxpayer's wealth, whatever the form or source of the receipt. It has been argued by some that this principle could be extended to include at least those benefits which relieve the employee of expenses otherwise normally borne by him as part of the ordinary cost of living.

The taxation of noncash benefits is a problem which chiefly affects low-bracket taxpayers. Where the benefit in question is one which is available to all company employees on a nondiscriminatory basis, for example, use of a company-maintained recreation area, there is a strong tendency to regard the benefit as a mere condition of employment and not as compensation. When, however, the benefit takes the form of special privileges for highly compensated personnel, such as the use of company automobiles or other special facilities, the employer thereby assuming the burden of some of the executive's personal living expenses, the relationship

between the benefit and the level of cash compensation appears much more clearly. Under the latter circumstances, there is presumably far less hesitation on the part of the Internal Revenue Service in valuing and imposing a tax upon the benefit received.

Whether fringe benefits should be brought within the coverage of the income tax is primarily a question of policy, since the scope of the definition of income is clearly wide enough to include these items if Congress should desire that they be included. Perhaps, as suggested above, the most difficult questions that would arise in connection with any full-scale effort to tax fringe benefits relate to the valuation of these benefits. But even these difficulties can be surmounted, as indicated by the experience under other federal and state statutes. Thus, the Federal Insurance Contributions Act and the Federal Unemployment Tax Act are based on "wages" a term which, in application, is defined to include the fair market value of any remuneration received in noncash form. Under these statutes, meals and lodging furnished as part of the employee's total compensation, are included in the tax base on the basis of their fair market value. The state unemployment insurance acts, in general, follow the federal definition; in some instances, the states have provided statutory and administrative guidance regarding the valuation of common types of noncash benefits. Finally, the Fair Labor Standards Act (section 3(m)) uses the term "wage" and provides, in effect, that "wage" shall include the reasonable cost to the employer of furnishing board, lodging, or other facilities, if these items are customarily furnished to employees. Valuation problems do not appear to have proven troublesome in the administration of this provision.

But in spite of the importance and growing popularity of noncash employee benefits, Congress has not yet faced squarely the policy and administrative problems created by their use. The trend of recent legislation has been to exempt these benefits from tax, possibly for the reason that their enjoyment is greatest among low-income taxpayers. Yet there has been no major Congressional or Treasury study of this problem.

b. MEALS AND LODGING. Meals and lodging furnished to employees are probably the most familiar type of noncash benefit. In the typical case, the employee (for example, a doctor on the staff of a hospital) is required by the exigencies of his employer's business to accept his meals and living quarters on the employer's business premises. Since the employee thus receives accommodations which he would otherwise be obliged to purchase for himself, it seems clear that the saving thereby achieved constitutes a gain which, in many cases, could be included within the income definition.

Historically, however, the issue has been drawn more narrowly than this. As regarded by the courts and the Service, the question has been whether the value of these items should be included in the

employee's income as "compensation for services", or excluded on the ground that the meals and lodging are furnished primarily "for the convenience of the employer". Prior to the enactment in 1954 of section 119, the law was in a state of transition. Initially, the Tax Court and the Service had applied the "convenience of the employer" test to exclude from an employee's income the value of meals and lodging furnished by his employer where it appeared that the employee could not otherwise perform the services required of him and where the employee's personal convenience was therefore deemed "secondary" to the needs of the employer's business. Subsequently, however, the Service altered its position somewhat and held that where the circumstances indicated that the receipt of meals and lodging by an employee represented compensation for services rendered, the fair market value thereof would be taxed to the employee even though the meals and lodging were furnished for the convenience of the employer and were accepted by the employee as a condition of his employment. The Tax Court approved this later position in several cases involving living quarters furnished an employee—for example, in the case of a maintenance engineer employed by a college and required to live on the college premises—but at least one court of appeals has held that the "convenience of the employer" standard has been too well established thus to permit its displacement.

Section 119, enacted in 1954, represents a return to an approximation of the original Tax Court and Service position by placing primary emphasis upon the "convenience of the employer" test rather than the factor of intended compensation. Under section 119, the value of meals and lodging furnished for the convenience of the employer is excluded from gross income, whether or not the meals and lodging are also intended as compensation to the employee. In the case of meals, the exclusion applies only if the meals are furnished on the business premises of the employer. In the case of lodging, the exclusion applies only if the employee is required to accept the lodging on the employer's business premises as a condition of employment. 162/

ALLOWANCES

Unlike the position in Canada, where an employee may be taxed in respect of an allowance from which he derives no personal benefit but uses it to meet certain business expenses for which he can claim no deduction by reason of the restrictive provisions of section 5, the general rule in the United States appears to be that an employee is taxable only to the extent that he benefits personally from an allowance or reimbursement paid to him by his employer. While an employee is required to include an allowance or

reimbursement in his gross income, he is entitled to deduct his operating expenses as an employee, since his employment is regarded as a trade or business. "Necessarily, the latter expenses are limited in amount and variety since employees normally incur few expenses of a business nature". 163/ Expenses incurred by an employee in connection with the performance of his duties would be deductible, so that only that portion of his allowance which he used for personal living or family expenses would be taxable as additional compensation, as would reimbursement for these personal expenses.

The reporting requirements differ in the case of (a) employees who receive advances or reimbursements for expenses in respect of which they must "adequately account" to their employers and (b) employees receiving similar payments who are not so required to account.

(a) Employees required to account

As a technical matter, it appears that amounts received by an employee as reimbursement for travel and entertainment expenses incurred in connection with the performance of his duties are initially included in the employee's gross income, but can then be deducted by him in computing his adjusted gross income... The Regulations, however, provide that an employee need not report in his income tax return travel and entertainment expenses incurred on behalf of his employer if the employee is required to, and does, "adequately account" for the expenses to his employer, and if the reimbursement exactly equals the amount of the expenses. If total reimbursements exceed expenses, then, of course, the excess must be included in the employee's gross income. The tax return form, however, does require the employee to state whether he has received an expense allowance from or has charged expenses to his employer, and likewise to indicate whether he has submitted an itemized accounting of such expenses to the employer.

An "adequate accounting" for this purpose means "the submission to the employer of an account book, diary, statement of expense, or similar record maintained by the employee in which the information as to each element of an expenditure...is recorded at or near the time of the expenditure, together with supporting documentary evidence, in a manner which conforms to all the 'adequate records' requirements" previously described... The employee must account for all amounts received from the employer

as advances or reimbursements, including amounts charged to the employer through credit cards, for travel, or for entertainment and gifts.... It then becomes the responsibility of the employer to retain these records and documents in order to substantiate deductions for the allowances and reimbursements paid to the employee. As a measure of simplification, an employee will generally be deemed to have made an adequate accounting to his employer and to have met the requirements of substantiation if, in connection with business travel, he receives a fixed per diem travel allowance not in excess of \$25 a day or a fixed transportation allowance not in excess of 15 cents a mile. 164/

(b) Employees not required to account

An employee who does not account to his employer for his business expenses and who receives amounts as advances or reimbursements must account for such expenses to the Internal Revenue Service. As part of his return, he must submit a statement showing (1) the total amount charged to his employer and received from his employer as advances or reimbursement, and (2) the total of his business expenses, broken down into such broad categories as transportation, meals, and lodging while away from home, entertainment, and other expenses. In addition, the employee must maintain such records and supporting evidence as will substantiate each necessary element of an expenditure. These requirements also apply to an employee who claims a deduction for business expenses in excess of the total amounts reimbursed by his employer; to an employee who is "related" to his employer, such as an employee owning more than 10% of his employer's stock; and in general, to employees whose employers' accounting procedures are deemed inadequate. With these exceptions, an employee on an expense account who makes an "adequate accounting" to his employer will not again be required to substantiate the expense account information. 165/

APPRAISAL

The Taxation of Benefits

The major problems to which the policy of taxing benefits, as embodied in section 5(1)(a), gives rise are threefold:

- (a) the determination of what benefits are taxable under section 5(1)(a);
- (b) the valuation of benefits in kind;
- (c) securing the disclosure and fair valuation of taxable benefits in income tax returns.

These problems will be dealt with seriatim.

DETERMINATION OF TAXABLE BENEFITS

The meaning of the expression "other benefits of any kind whatsoever" has been only briefly considered by the Tax Appeal Board and not at all by the Exchequer Court or the Supreme Court of Canada, so that its precise scope is not clearly marked out. In view of the wide and growing diversity of benefits in kind, the use of such comprehensive language, which reflects the "shotgun" rather than the "sniper" approach in the taxation of benefits, seems perfectly justified. 166/

The United Kingdom Royal Commission on the Taxation of Profits and Income envisaged circumstances which would provide scope for this approach:

...the provision of untaxable benefits in kind is capable of becoming an abuse of the tax system. The reason is not simply that high taxation gives a special attraction to all forms of untaxed receipt. Modern improvements in the conditions of employment and the recognition by employers of a wide range of obligation towards the health, comfort and amenities of their staff may well lead to a greater proportion of an employee's true remuneration being expressed in a form that is neither money nor convertible into money. It is plain that any development of this tendency will need careful watch; and it is possible that it may have to be dealt with by special legislation. We cannot foretell what form such legislation ought to take. If the development were primarily to be regarded as a form of tax avoidance, it might be controlled by disallowing the related expenditure in the employer's profit assessment. On the other hand, regarded as a desirable social development, it might have to be regulated by the extremely difficult process of declaring specified types of benefit to be taxable income. [Emphasis added.] 167/

At the administrative level, the Department of National Revenue in Information Bulletin No. 24, would appear to have given an excessively narrow interpretation to "other benefits" by sanctioning the exclusion from income, on grounds of administrative convenience for the most part, of

valuable advantages which would seem clearly to fall within the statutory language—for example, discounts on merchandise, passes to employees of transportation enterprises, and interest-free loans—and to this extent has contributed to the erosion of the tax base. While no doubt some latitude in the administration of this difficult area is necessary, say, to permit the exclusion of benefits of very little value, it is not clear what administrative difficulties warrant the exclusion of the above-mentioned items.

VALUATION

The meaning of "value" in the expression "value of board and lodging and other benefits of any kind whatsoever" is not clear, and no guides to valuation of taxable benefits in kind are provided either by the Income Tax Act or the Regulations. To ascribe to "value" the meaning of "value to the employee" would result in the most equitable treatment of the employee, if we subscribed to the view held by certain economists—for example, Irving Fisher—that income is essentially a flow of satisfactions. This course involves a most onerous administrative burden, necessitating a detailed consideration of the individual circumstances of the recipient. The difficulties are fewer if "value" is taken to mean "fair market value". Another alternative would be to define "value" in terms of "cost to the employer", the course which the United Kingdom Parliament adopted in its special legislation of 1948. In the interests of administrative expediency, particularly in view of the steadily growing use of benefits in kind, this solution to the valuation problem has much to recommend it, although it must be viewed in the light of the argument of the Department of National Revenue that employees in remote areas would be harshly dealt with under such a method of valuation. The weight of this argument could be better

assessed if it were known how many employees would be adversely affected, and to what extent.

THE REPORTING OF BENEFITS

No comprehensive study has ever been made of the extent to which fringe benefits are used in Canadian industry, so that it cannot be said with assurance whether Canadian officers and employees do report as income the benefits they receive from their employers and also assign reasonable values to them, or whether the use of benefits in kind constitutes a major source of tax avoidance. As a first step in the resolution of this problem, the Department of National Revenue might well require information on the subject from all employers, to be submitted either in their income tax returns or in special information returns. Information might also be elicited in employees' tax returns, perhaps through the use of check lists. Indeed, the portent of the development in this area of taxation appears in the following statement of a senior official of the Department of National Revenue:

As an income tax administrator, I cannot be blamed for looking with some apprehension at recent trends in the direction of increased fringe benefits and tax concessions to employees. It seems quite possible that the essential simplicity of the employees' income tax return may some day become a thing of the past. As fringe benefits with tax implications increase and further deductions are provided for various types of travelling and living expenses, the possibilities for error or fraud in employees' returns may so multiply as to require entirely different methods of enforcement.... Incidentally, our experience with fringe benefits and other problems related to these returns does not make the possibility of ever having to deal with a large volume an encouraging prospect. 168/

While the burden of compliance by employers is doubtless increased by requiring them to report in detail the benefits they provide for employees, if they choose to compensate their staffs with benefits in kind, they can hardly be heard to complain.

The Taxation of Allowances

Here, again, Parliament has adopted the "shotgun" approach, rather than the "sniper" approach, by requiring the inclusion in income of "all amounts received...as an allowance for personal or living expenses or as an allowance for any other purpose" with specified exceptions. And properly so, for full disclosure is thereby obtained in the tax return.

However, an injustice may be worked in circumstances where an employee receives an allowance which is intended to be, and is, spent to meet business expenses which the employee cannot deduct because of the restrictive provisions for deductions in the computation of income from an office or employment in section 5. See, for example, Hawkins v. M.N.R. *supra*, at page 90. The questionable decision in Bherer v. M.N.R., which is under appeal to the Exchequer Court, may have been prompted by a desire on the part of the Board to obviate this injustice. In any event, the solution would seem to be to permit the deduction from allowances required to be included in the computation of income of the amounts thereof spent in pursuit of the employer's business objectives, which expenditures the employee would have to fully substantiate.

Although the meaning of the term "allowance" in section 5(1)(b) has been little explored by the courts, it probably does not include an accountable advance or a reimbursement, so that the receipt of such payments would not be disclosed in a tax return. However, such payments may be devoted in whole or in part to the personal use of employees and should be included in their income as a benefit. As an aid to more comprehensive reporting of income, Parliament might well adopt a provision similar to that found in United States income tax law whereby an employee who must and does "adequately

account" to his employer for travel and entertainment expenses, and who is reimbursed for them, does not have to include the amount in his income but must nevertheless state in his tax return form whether he has received an expense allowance from or has charged expenses to his employer, and also indicate whether he has submitted an itemized account of such expenses to his employer. The disclosure in the tax return of the amounts received as reimbursements or accountable allowances would serve to alert the Department of possible abuse and permit inquiry in suspicious circumstances.

REFERENCES

- 1/ Many of the comments relating to the taxation of benefits are taken from D. J. Sherbaniuk, "The Taxation of 'Benefits' Under Sec. 5(1)(a) of The Income Tax Act", I Alberta Law Review (1960), 369.
- 2/ For data on fringe benefits, see Fringe Benefit Costs in Canada - 1961, Industrial Relations Counsellors Service, Inc., Toronto, 1962. Studies covering the years 1957 and 1959 have also been published. Taxation Statistics, published annually by the Department of National Revenue, is also informative.
- 3/ It has been argued that, relative to other classes of workers, the executive is much worse off today than he used to be, as a result of the combined effect of high taxes and the increased cost of living. See L. E. Coward, "Tax Planning for The Executive", Report of the 11th Annual Tax Conference, Canadian Tax Foundation, 1957, 162 at p. 163.
- 4/ Henry C. Simons, Personal Income Taxation, The University of Chicago Press, 1938, p. 124.
- 5/ [1892] A.C. 150.
- 6/ F. E. LaBrie, The Meaning of Income in the Law of Income Tax, sponsored by the Canadian Tax Foundation, University of Toronto Press, 1953, p. 46.
- 7/ [1892] A.C. 150 at pp. 163-64.
- 8/ Ibid., p. 156.
- 9/ See H. Plaxton, The Law Relating to Income Tax and Excess Profits Tax of the Dominion of Canada (2nd ed.) The Carswell Company, Limited, 1947, pp. 31 and 40.
- 10/ [1959] C.T.C. 308 at p. 312, 59 DTC 1159 at p. 1161.
- 11/ An Act to Authorize the Levying of a War Tax upon Certain Incomes, R.S.C., 1927, Chapter 97, as amended.
- 12/ [1938] Ex. C. R. 225 at p. 231; [1938-39] C.T.C. 128 at p. 134; 1DTC 456 at p. 458.
- 13/ H. Plaxton, op. cit., at p. 63. On the other hand, if it is true, as this statement suggests, that the section was intended to include only perquisites that were received as a reward for services, then it would seem to follow that the value of living quarters occupied by an employee in the course of carrying out the duties, as in Tennant v. Smith, would not have fallen to be taxed under section 3(1)(e).
- 14/ [1946] Ex. C.R. 634; [1947] C.T.C. 29, 2 DTC 918.
- 15/ The premiums were also held taxable as being "a gratuity indirectly received by the appellant from his employment with the company".

- 16/ 5 Tax A.B.C. (1951), 220; 51 DTC 426.
- 17/ R.S.C. 1952, Chapter 148, as amended.
- 18/ Williams v. M.N.R., [1955] Ex. C.R. 12 at p. 15; [1955] C.T.C. 1 at p. 3; 55 DTC 1006 at p. 1007.
- 19/ Ibid.
- 20/ Ex. C.R. at p. 15; C.T.C. at p. 3; DTC at p. 1007.
- 21/ 34 Tax A.B.C. (1963), 263 at p. 273; 64 DTC 62 at p. 69.
- 22/ Compare section 26(e) of the Australian Income Tax and Social Services Contribution Assessment Act (1936-1962) which reads: "The assessable income of a taxpayer shall include—(e) the value to the taxpayer of all allowances, gratuities, compensations, benefits, bonuses and premiums allowed, given or granted to him in respect of, or for or in relation directly or indirectly to, any employment of or services rendered by him, whether so allowed, given or granted in money, goods, land, meals, sustenance, the use of premises or quarters or otherwise". [Emphasis added.]
- 23/ In Williams v. M.N.R. supra, note 18, and No. 510 v. M.N.R., 19 Tax A.B.C. (1958) 226; 58 DTC 289, the parties agreed on the value of the benefits. In Banjavich v. M.N.R., 24 Tax A.B.C. (1960), 420; 60 DTC 419, the Minister increased the amount set out in the appellant's tax return as the value of her free board and lodging, although it is not clear in the case how his valuation was arrived at. The appellant failed to discharge the onus of proving that the assessment was wrong and her appeal was dismissed.
- 24/ [1892] A.C. 150 at p. 158.
- 25/ 26 Tax Cas. (1942), 381 at p. 389. Some doubt as to the correctness of these remarks appears to have been entertained by Roxburgh, J. in Abbott v. Philbin [1959] 2 All E.R. 270 at p. 273, where he said: "If that is good law...there may be some interesting and protracted valuations if they are conducted on the lines indicated by Wrottesley, J."
- 26/ 6 S.A.T.C. 59 at p. 60.
- 27/ 12 C.T.B.R. 108 at p. 109.
- 28/ B. T. Bittker, "The Individual as Wage Earner", Proceedings of the Eleventh Annual Institute on Federal Taxation, New York University, 1953, p. 1147.
- 29/ House of Commons Debates, 1956, vol. 7, p. 6764.
- 30/ Weight v. Salmon, 19 Tax Cas. (1934), 174.
- 31/ Wilkins v. Rogerson, [1961] 1 All E.R. 358.

- 32/ [1961] British Tax Review 22.
- 33/ Taxable benefits received by directors and employees receiving over £2,000 per annum are measured by the expense to which the company or employer has been put in providing them: Income Tax Act, 1952, section 161. The treatment of taxpayers under the legislation has been criticized as unreasonable in S. Bates, "Notes of Recent Cases—Onerous Benefits", [1964] British Tax Review 361.
- 34/ [1961] 3 All E.R. 348.
- 35/ L. Eisenstein, "A Case of Deferred Compensation", 4 Tax Law Rev. (1949), 391 at p. 410.
- 36/ 9 Tax A.B.C. (1953), 241 at pp. 246-47; 53 DTC 419. At page 169 of the dictionary referred to, "benefit" is defined to include: "(a)... 1. A thing well done; a good deed...2. A kind deed; a favour, gift.... 3. Advantage, profit, good....(c) Pecuniary profit...." At p. 27, "advantage" is defined to include: II...1. Benefit, increased well-being....2. Pecuniary profit, interest...."
- 37/ 20 Tax A.B.C. (1958), 242 at p. 246; 58 DTC 608.
- 38/ In Sutton v. C.I.R., 14 Tax Cas. (1929), 662, an argument by counsel raised the question of whether a bequest of the right to have a free meal at the testator's establishment was income to the beneficiary. "Well, I think perhaps the answer to that is that that may be dealt with as the minimum with which the law does not concern itself", said Rowlett, J. at p. 679.
- 39/ Earl Jowitt's Dictionary of English Law, at p. 698, defines the expression "ejusdem generis" as follows: "of the same kind or nature. It is a rule of construction of documents that general words following an enumeration of particulars are to have their generality limited by reference to the preceding particular enumeration, and to be construed as including only all other articles of the like nature and quality. Thus, the Sunday Observance Act, 1677, enacts that no tradesman, artificer, workman, labourer, 'or other person whatsoever' shall follow his ordinary calling on Sunday; here the word 'person' was held to be confined to those of callings of the same kind as those specified by the preceding words, so as not to include a farmer...or an estate agent".
- 40/ 12 Tax A.B.C. (1954-55), 335 at p. 339; 55 DTC 192. A similar argument with respect to the meaning of Schedule E of the English statute met with the same fate in Cowan v. Seymour, [1920] 1 K.B. 500 at pp. 507-08.
- 41/ 13 Tax A.B.C. (1955), 264 at pp. 269-70; 55 DTC 428. Mr. Cecil Snyder, now Chairman of the Board, apparently shared Mr. Fordham's opinion for, without mention of the ejusdem generis rule, he held taxable certain benefits other than board and lodging. See, for example, No. 350 v. M.N.R., 15 Tax A.B.C. (1956), 330; 56 DTC 369 (company automobile used by its president).

42/ S.C. 1956, Chapter 39, section 1.

43/ When the Government proposed to amend the Act to read "other benefits of any kind whatsoever", strenuous objection to the broad language was raised, and the suggestion was made that only the benefits intended to be taxed should be specifically included. The Minister of Finance, the Honourable Walter Harris, defended the amendment as follows: "I am free to admit that if one could draft a clause which would set out all the known kinds of benefits that are given by employers it would be more desirable, but these fluctuate from time to time and are very numerous. I suggest to the committee that we do this on the basis that I have suggested, namely that we do not intend to extend the present practice of assessing every kind of benefit I described last night, and then if at a later time it is brought to my attention that there has been an increase in the class of gifts or benefits provided for I will agree that that was not intended and we would then have an amendment to provide for it specifically. If we tried to define the several kinds of gifts we would only end up as we are now with having to have some general clause which in itself would be just as broad and as indefinite as the present words in this". House of Commons Debates, 1956, vol. 7, p. 6763.

44/ Mansfield v. M.N.R., 28 Tax A.B.C. (1962), 404 at p. 415.

45/ 13 Tax A.B.C. (1955), 264 at p. 273; 55 DTC 428. He reiterated this view in Norris v. M.N.R., 17 Tax A.B.C. (1957), 257 at p. 261; 57 DTC 301, where the issue was similar.

46/ Whether a particular benefit has been received or enjoyed "in respect of, in the course of, or by virtue of the office or employment" is discussed, infra.

47/ 15 Tax A.B.C. (1956), 330; 56 DTC 369. The taxpayer was apparently assessed in his capacity as officer under section 5(1)(a) and in his capacity as shareholder under section 8(1), both of which sections require the inclusion in income of the value of "benefits". There is no reason to attribute a different meaning to that word as used in several sections of the Act. See Sir P. B. Maxwell, The Interpretation of Statutes, 10th ed., p. 322: "It has been justly remarked that, when precision is required, no safer rule can be followed than always to call the same thing by the same name. It is, at all events, reasonable to presume that the same meaning is implied by the use of the same expression in every part of an Act.... But the presumption is not of much weight. The same word may be used in different senses in the same statute and even in the same section."

48/ 18 Tax A.B.C. (1957-58), 90; 57 DTC 509.

49/ 14 Tax A.B.C. (1955-56), 279; 56 DTC 59. The assessment was made under s. 8(1)(c).

50/ 21 Tax A.B.C. (1958-59), 219; 59 DTC 82. The assessment was apparently made under s. 8(1).

- 51/ 19 Tax A.B.C. (1958), 226; 58 DTC 289.
- 52/ In Case 049, 3 T.B.R.D. (1952), 269, the Australian Taxation Board of Review held that the provision of free board and lodging for the taxpayer's daughters and step-son, for whose maintenance and support he accepted full responsibility, was an allowance or benefit granted to him in respect of his employment, and, therefore, was part of his assessable income.
- 53/ 21 Tax A.B.C. (1958-59), 219; 59 DTC 82.
- 54/ 17 Tax A.B.C. (1957), 186, at pp. 188-189; 57 DTC 299. To the same effect is No. 247 v. M.N.R., 12 Tax A.B.C. (1954-55), 335; 55 DTC 192. Even in the absence of a statutory provision as broad as section 5(1)(a), the same result was reached by the English courts: see Weight v. Salmon, 19 Tax Cas. 174.
- 55/ A restriction on the right of disposal of the shares is a factor to be considered in the valuation of the benefit: Ede v. Wilson, 26 Tax Cas. (1945), 381, discussed supra, p. 43.
- 56/ 20 Tax A.B.C. (1958), 242; 58 DTC 608.
- 57/ Section 16(1), as it then read, provided: "A payment or transfer of money, rights or things made pursuant to the direction of, or with the concurrence of, a taxpayer to some other person for the benefit of the taxpayer or as a benefit that the taxpayer desired to have conferred on the other person shall be included in computing the taxpayer's income to the extent that it would be if the payment of transfer had been made to him."
- 58/ See supra, p. 50.
- 59/ 20 Tax A.B.C. (1958), 242 at p. 246; 58 DTC 608.
- 60/ 16 Tax A.B.C. (1956-57), 24; 56 DTC 475.
- 61/ Ibid., Tax A.B.C. at pp. 27-28.
- 62/ 19 Tax A.B.C. (1958), 431; 58 DTC 428.
- 63/ Ibid., Tax A.B.C. at 433.
- 64/ M.N.R. v. Pillsbury Holdings Limited, [1964] C.T.C. 294; 64 DTC 5184.
- 65/ 35 T.C. (1961), 1083.
- 66/ Ibid., p. 1090.
- 67/ Ibid., p. 1091.
- 68/ Hartland v. Diggines, [1926] A.C. 289 (payment of employee's income tax); Nicoll v. Austin, 19 Tax Cas. (1935), 531 (payment of maintenance costs of employee's home).

- 69/ Salter v. M.N.R. [1946] Ex. C. R. 634; [1947] C.T.C. 29; 2 DTC 918 (payment of employee's income tax).
- 70/ 14 Tax A.B.C. (1955-56), 241; 56 DTC 34.
- 71/ 13 Tax A.B.C. (1955), 101; 55 DTC 321.
- 72/ To the same effect is No. 523 v. M.N.R., 19 Tax A.B.C. (1958), 360; 58 DTC 379.
- 73/ 19 Tax Cas. (1935), 618.
- 74/ Per Maugham, L. J. at p. 641. Cf. Fuller v. M.N.R., 5 Tax A.B.C. (1951), 220; 51 DTC 426, discussed supra.
- 75/ 13 Tax A.B.C. (1955), 264; 55 DTC 428.
- 76/ Ibid., Tax A.B.C. at p. 273; DTC at p. 434. He also reasoned that the policy in question could very well have been considered as a "group insurance plan" within the meaning of the exception in section 5(1)(a), and since the word "approved" applied only to "superannuation fund or plan" and not to "group insurance plan", the employer's contributions fell within the exception and were not taxable to the appellant.
- 77/ In Norris v. M.N.R., 17 Tax A.B.C. (1957), 257; 57 DTC 301, the rights of the appellant to receive benefits under the staff assurance scheme there in question were subject to forfeiture on a number of grounds until his retirement. The Tax Appeal Board held, following the Pazuk case, that the appellant was not taxable in respect of his employer's contributions to the scheme in the years they were made.
- 78/ 179 F. 2d 863 (2d Cir., 1950).
- 79/ Ibid., pp. 865-866. The Court explained that the policy was worth less to the annuitant than the premium paid because the employer's retention or possession of the policy precluded him from exercising the privilege of accelerating the date of annuity payments. That privilege must have been taken into account in fixing the premium, and hence, deprivation of ability to exercise the privilege decreased the value of the policy to the annuitant below its cost to the employer.
- 80/ [1963] 3 All E.R. 325.
- 81/ Ibid., p. 327.
- 82/ Ibid., p. 329.
- 83/ 41 Tax Cas. (1964), 641.
- 84/ Ibid., p. 657.
- 85/ Ibid., pp. 655-56. The treatment of taxpayers under the legislation has been criticized as unreasonable in S. Bates, "Notes of Recent Cases—Onerous Benefits," [1964] British Tax Review 361.

- 86/ Canadian Tax Reporter, Toronto: CCH Canadian Limited, vol. 1, para. 10-406.
- 87/ Fringe Benefit Costs in Canada—1961, Table 1, p. 13, Industrial Relations Counsellors Service, Inc., Toronto, 1962.
- 88/ Guttentag, Leonard and Rodewald, "Federal Income Taxation of Fringe Benefits: A Specific Proposal", 6 National Tax Journal (1953), 250 at p. 264.
- 89/ 13 Tax A.B.C. (1955), 264 at p. 271; 55 DTC 428 at p. 433.
- 90/ National Industrial Conference Board, Studies in Personnel Policy, No. 102, Employee Recreational Activities, 1949, p. 38, cited in Guttentag et al., "Federal Income Taxation of Fringe Benefits: A Specific Proposal", supra, reference 88 at p. 266.
- 91/ For a more detailed examination of this form of benefit, see the discussion of "Hospital Insurance" in Chapter 9.
- 92/ [1953] 1 S.C.R. 211. See the discussion infra, particularly in reference 98, of the words "in respect of, in the course of, or by virtue of the office or employment".
- 93/ House of Commons Debates, 1956, vol. 7, p. 6768.
- 94/ See infra, reference 98.
- 95/ See Wing v. O'Connell, [1927] I.R. 84 and Hofman v. Wadman, 27 Tax Cas. (1946), 192.
- 96/ [1955] Ex. C.R. 12 at p. 14; [1955] C.T.C. 1 at p. 2; 55 DTC 1006 at p. 1007.
- 97/ Ibid.
- 98/ Notwithstanding the difference in wording between the relevant sections of the Canadian and English statutes, the striking similarity between the wording of section 5(1)(a) and the language used by some of the judges in construing the English acts affords some justification for seeking guidance in this area in the English authorities. Under the Income Tax Act, 1842, duty was charged by Rule 1 of Schedule E, "...for all Salaries, Fees, Wages, Perquisites, or Profits whatsoever accruing by reason of" offices or employments. In deciding whether a payment fell within the words "accruing by reason of such office", Collins, M. R. held in Herbert v. McQuade, [1902] 2 K.B. 631 at p. 649: "...the test is whether, from the standpoint of the person who receives it, it accrues to him in virtue of his office...." [Emphasis added.] Kellock, J. quoted this passage with approval in Goldman v. M.N.R., [1953] 1 S.C.R. 211 at p. 215; [1953] C.T.C. 95 at p. 99; 53 DTC 1096 at p. 1098, where he said: "In my view this reasoning is equally applicable to payments made to a person 'in connection with' an office or employment." In that case the Court was concerned with the meaning of section 3(4) of the Income War Tax Act, which provided: "Any payment

made to any person in connection with any duty, office or employment... shall be salary of such person and taxable as income for the purposes of this Act." [Emphasis added.] In Cowan v. Seymour [1920] 1 K.B. 500 at p. 518, Younger, L. J. held that "...the particular payment here in question was not a profit which accrued to the appellant in respect of that office." [Emphasis added.] Under the Income Tax Act, 1918, Rule 1 of Schedule E differed somewhat in wording from its predecessor, and charged a tax "...on every person having or exercising an office or employment of profit mentioned in this Schedule...in respect of all salaries, fees, wages, perquisites or profits whatsoever therefrom..." These words and the corresponding expressions contained in the earlier statutes were held by Viscount Cave, L. C. in Seymour v. Reed [1927] A.C. 554 not to be materially different. And indeed, language similar to that used by the courts in construing the old legislation may be found in decisions based on the new wording. In Corbett v. Duff [1941] 1 K.B. 730, Lawrence, J. held at p. 740 that "...it is impossible to hold that any of the payments to the appellants were not paid in respect of...the appellants' employment...." In Moorehouse v. Dooland [1955] 1 Ch. 284, Jenkins, L. J. echoed Collins, M. R. in Herbert v. McQuade, *supra*, when he said at pp. 303-04: "(i) The test of liability to tax on a voluntary payment made to the holder of an office or employment is whether, from the standpoint of the person who receives it, it accrues to him by virtue of his office or employment, or in other words by way of remuneration for his services." [Emphasis added.] Finally, in Hochstrasser v. Mayes, 38 Tax Cas. (1959), 673 at p. 706, Viscount Simonds said: "I accept, as I am bound to do, that the test of taxability is whether from the standpoint of the person who receives it the profit accrues to him by virtue of his office...." [Emphasis added.]

- 99/ [1953] 1 S.C.R. 211 at p. 219; [1953] C.T.C. 95 at p. 103; 53 DTC 1096 at 1100.
- 100/ 38 Tax Cas. (1959) 673.
- 101/ Ibid., p. 707.
- 102/ Ibid., p. 709. As for the Latin expressions, causa causans is the immediate or real effective cause, or a cause which causes, while causa sine qua non means "a cause which does not, in the sense material to the particular case, cause, but is merely an incident which precedes in the history of narrative of events...." Stroud's Judicial Dictionary, 3rd ed. vol. 1, p. 420. To the same effect see Beak v. Robson [1943] A.C. 352 at p. 355, and Cowan v. Seymour [1920] 1 K.B. 500 at pp. 517-18.
- 103/ See reference 99, *supra*.
- 104/ See *supra*, p. 70.
- 105/ 9 Tax A.B.C. (1953-54), 241; 53 DTC 419.
- 106/ To the same effect is Ede v. Wilson [1945] 1 All E.R. 367 at p. 368.

- 107/ 38 Tax Cas. (1959), 673.
- 108/ Ibid., p. 708.
- 109/ Ibid., p. 710
- 110/ Report of the Royal Commission on the Taxation of Annuities and Family Corporations, 1945, p. 36.
- 111/ House of Commons Debates, 1960-61, vol. 7 at p. 7830.
- 112/ S.C. 1956, Chapter 39, section 1.
- 113/ House of Commons Debates, 1956, vol. 7 at p. 6707.
- 114/ 13 Tax A.B.C. (1955), 264; 55 DTC 428.
- 115/ S.C. 1959, Chapter 45, section 1(1).
- 116/ House of Commons Debates, 1959, vol. 3 at p. 3825.
- 117/ See Information Bulletin No. 25, issued June 8, 1964, which is discussed supra, p. 73 and, in greater detail, in Chapter 9, in connection with "Hospital Insurance".
- 118/ S.C. 1956, Chapter 39, section 1.
- 119/ P. F. Vineberg, "Tax Position of Fringe Benefits", Corporate Management Conferences Canadian Tax Foundation, 1959, 77 at p. 87.
- 120/ S.C. 1960-61, Chapter 49, section 1(1).
- 121/ House of Commons Debates, 1960-61, vol. 7 at p. 7788.
- 122/ Ibid., p. 7797.
- 123/ S.C. 1959, Chapter 45, section 1(1).
- 124/ House of Commons Debates, 1959, vol. 2 at p. 2421.
- 125/ House of Commons Debates, 1959, vol. 3 at p. 3826.
- 126/ S.C. 1963, Chapter 21, section 1(1).
- 127/ House of Commons Debates, 1963, vol. 5 at p. 4250.
- 128/ S.C. 1963, Chapter 21, section 27(1).
- 129/ [1943] C.T.C. 47; 2 DTC 610.
- 130/ Ibid., C.T.C. at p. 72; DTC at p. 621.
- 131/ Ibid., C.T.C. at p. 73; DTC at p. 621.

- 132/ Kenneth B. S. Robertson Ltd. v. M.N.R. [1944] C.T.C. 75; 2 DTC 655.
- 133/ F. E. LaBrie, The Meaning of Income in the Law of Income Tax, University of Toronto Press, 1953, p. 46.
- 134/ S.C. 1943-44, Chapter 14, section 2; amended by S.C. 1946, Chapter 55, section 2.
- 135/ The following types of allowance were held to be taxable: entertainment allowance: Trudeau v. M.N.R., 3 Tax A.B.C. (1950), 24; 50 DTC 427; Mr. S. v. M.N.R., 2 Tax A.B.C. (1950), 341; 50 DTC 390; automobile allowance: Hawkins v. M.N.R., 3 Tax A.B.C. (1950), 130; 50 DTC 472; Campbell v. M.N.R., 13 Tax A.B.C. (1955), 273; 55 DTC 434; Woodland v. M.N.R., 5 Tax A.B.C. (1951), 111; 51 DTC 374; Sjolie v. M.N.R., 5 Tax A.B.C. (1951), 309; 52 DTC 19; subsistence allowance: Scanlan v. M.N.R., 3 Tax A.B.C. (1951), 329; 51 DTC 84; sales promotion allowance: No. 14 v. M.N.R., 4 Tax A.B.C. (1951), 1; 51 DTC 129; and a salesman's weekly allowance: Hodge v. M.N.R., 5 Tax A.B.C. (1951), 251; 51 DTC 420.
- 136/ Supra, reference 135.
- 137/ Ibid., Tax A.B.C. at pp. 131-33; DTC at pp. 472-73. Accord: Campbell v. M.N.R., supra, reference 135, discussed infra.
- 138/ See, for example, Trudeau v. M.N.R., and Mr. S. v. M.N.R., supra, reference 135.
- 139/ Challoner and Greenwood, Income Tax Law and Practice (Commonwealth) (2nd ed. 1962) The Law Book Co. of Australasia Pty. Ltd., at p. 211.
- 140/ 34 Tax A.B.C. (1963-64), 365 at p. 368; 64 DTC 130 at p. 132.
- 141/ 30 Tax A.B.C. (1963), 367; 63 DTC 44.
- 142/ Ibid., Tax A.B.C. at pp. 375-76; DTC at p. 45.
- 143/ 13 Tax A.B.C. (1955), 273; 55 DTC 434.
- 144/ Ibid., Tax A.B.C. at p. 278; DTC at p. 437.
- 145/ [1963] C.T.C. 64; 63 DTC 1059.
- 146/ The following types of allowances have been held taxable: entertainment allowance: Forest v. M.N.R., 11 Tax A.B.C. (1954), 444; 54 DTC 547; automobile allowance: Campbell v. M.N.R., supra, reference 143; travelling allowance: Quance v. M.N.R., 6 Tax A.B.C. (1952), 338; 52 DTC 237; Pelletier v. M.N.R., supra, reference 145; educational allowance: Bailey v. M.N.R., 26 Tax A.B.C. (1961) 362; 61 DTC 287.
- 147/ For comments on the tax treatment of allowances received by Members of Parliament see Appendix A to this chapter.
- 148/ Lancelot J. Smith, "Tax Position of Fringe Benefits", Corporate Management Conferences, Canadian Tax Foundation, 1959, 59 at p. 63.

- 149/ Cmd. 9474, London: H.M.S.O., 1955, p. 68, para. 211.
- 150/ G.S.A. Wheatcroft, The Law of Income Tax, Surtax and Profits Tax (First Supplement, 1964), Sweet & Maxwell, pp. 3-4.
- 151/ [1926] A.C. 289 at p. 292.
- 152/ 19 Tax Cas. (1935), 531.
- 153/ Cmd. 9474, supra, reference 149, p. 68, para. 210.
- 154/ Ibid., p. 68, para. 211.
- 155/ G.S.A. Wheatcroft, The Law of Income Tax, Surtax and Profits Tax, London: Sweet & Maxwell, Limited, 1962, p. 1074.
- 156/ Income Tax Act, 1952, section 456.
- 157/ Income Tax Act, 1952, section 457(3).
- 158/ Income Tax Act, 1952, section 457(4).
- 159/ G.S.A. Wheatcroft, supra, reference 155, at pp. 1074-75.
- 160/ Ibid., at pp. 1075-77.
- 161/ Cmd. 9474 supra, reference 149, p. 69, para. 215.
- 162/ Harvard Law School, World Tax Series: Taxation in the United States, Commerce Clearing House Inc., 1963, at pp. 538-41.
- 163/ Ibid., at p. 564.
- 164/ Ibid., at p. 580-81.
- 165/ Ibid., at p. 581.
- 166/ Certain Members of the Opposition objected to the broad scope of "other benefits of any kind whatsoever" and would apparently have substituted specific clauses directed at the particular benefits which were intended to be taxed. See House of Commons Debates, 1956, vol. 7 at p. 6711.
- 167/ Cmd. 9474, supra, reference 149, pp. 71-72, para. 222.
- 168/ H. H. Milburn, "Methods of Enforcing the Personal Income Tax", Report of the 12th Annual Tax Conference, Canadian Tax Foundation, 1958, 273 at p. 277.

APPENDIX ATAX TREATMENT OF EXPENSE ALLOWANCES
OF MEMBERS OF PARLIAMENT

Section 44(1) of the Senate and House of Commons Act, R.S.C. 1952, Chapter 249, as amended by Chapter 14, S.C. 1963, reads:

(1) For each session of Parliament, there shall be allowed to each member of the Senate and House of Commons such actual moving or transportation and travelling expenses between his place of residence or his constituency and Ottawa, and such actual telecommunication expenses incurred while in Ottawa, as each House may by order prescribe for its own members.

The underlined words are new. The old section 44(1) reads:

For each session of Parliament, there shall also be allowed to each member of the Senate and of the House of Commons his actual moving or transportation expenses, and reasonable living expenses while on the journey between his place of residence and Ottawa, going and coming, once each way.

The explanatory note in the bill says that the amendment is to provide that each member will be allowed such actual moving or transportation and travelling expenses between his residence or constituency and Ottawa as each House may prescribe. These expenses, being "actual" expenses would appear to have to be accounted for.

(2) (This subsection deals with a motor vehicle allowance of two thousand dollars for each Minister of the Crown and the Opposition Leader, and of one thousand dollars for **each of the two Speakers.**)

(3) In addition to the expenses provided for in subsection (1), there shall be paid to each member of the Senate and House of Commons an allowance for expenses incidental to the discharge of his duties as a member

- (a) in the case of a member of the Senate, at the rate of three thousand dollars per annum; and
- (b) in the case of a member of the House of Commons, at the rate of six thousand dollars per annum.

(4) The allowances described in subsection (3) shall be paid quarterly to each member...and shall be subject to a deduction in respect of non-attendance at sittings of the House of which he is a member equal to the deduction from the sessional allowance of a member provided for in section 36.

It would appear that the expense allowance in subsection (3), though subject to a deduction in respect of non-attendance by subsection (4), need not be accounted for.

In summary, it seems that:

(1) Members of Parliament are accountable for expenses in respect of which allowances are claimed by virtue of section 44(1).

(2) Members of Parliament are not accountable for the other expenses incidental to their duties as a member because section 44(3) grants a fixed allowance without any requirement to account.

CHAPTER 4

THE CANADIAN TAX TREATMENT OF BENEFITS ARISING FROM STOCK OPTIONS AND STOCK PURCHASES

INTRODUCTION

It is the practice of some Canadian companies to make stock available to certain of their executive personnel and, occasionally, rank and file employees, on terms which are either immediately or prospectively advantageous. The reason most frequently advanced in defence of the practice is that it provides the privileged employees with an incentive to promote the growth of the company by permitting them to participate in its success. 1/ Stock acquisition arrangements have also been employed for other purposes, for instance, as an inducement to prospective employees to enter into contracts of employment, 2/ as compensation for past and future service, 3/ for reasons of security, and also 'as a status symbol which gives the executives some standing with the employees of the company commensurate with their important position. 4/ The benefits available under stock acquisition arrangements can be very substantial and since 1953 certain of these benefits have been accorded special treatment under section 85A of the Income Tax Act. Before examining that section in detail, it will be useful to consider both the tax treatment of stock option and stock purchase benefits prior to its enactment and also the method of taxing such benefits which do not fall within its scope.

HISTORY OF THE TAX TREATMENT OF
STOCK ACQUISITION ARRANGEMENTS

Income War Tax Act

The word "income" was defined in section 3 of the Income War Tax Act in part as follows:

3. (1) For the purposes of this Act, "income" means the annual net profit or gain or gratuity, whether ascertained and capable of computation as being wages, salary, or other fixed amount, or unascertained as being fees or emoluments, or as being profits from a trade or commercial or financial or other business or calling, directly or indirectly received by a person from any office or employment, or from any profession or calling, or from any trade, manufacture or business,...[Emphasis added.]

Not a single case involving the taxability of bargain purchases of stock by employees in their corporate employers was litigated under the Income War Tax Act, a fact which lends support to the view that "before the enactment of the Income Tax Act in 1948, profits from stock options were treated as capital gains". ^{5/} It is perhaps a matter for speculation whether the courts would have held such benefits to be taxable as "emoluments", which word is defined in the Shorter Oxford Dictionary (3rd ed.) p. 601 as "profit or gain from station, office or employment; dues, remuneration, salary". English courts have held that gains arising from bargain purchases of stock are taxable as "perquisites or profits" from an office or employment. ^{6/}

Income Tax Act

The Income Tax Act of 1948, which replaced the Income War Tax Act, and which was re-enacted as the Income Tax Act, R.S.C. 1952, Chapter 148, provides, in the general language of section 3, for the inclusion in income for tax purposes of income from "offices and employments". The determination of income from these sources is more specifically provided for in sections 5 and 25.

SCOPE AND EFFECT OF SECTION 5(1)(a)

Section 5(1)(a) provides in part as follows:

5. (1) Income for a taxation year from an office or employment is the salary, wages and other remuneration, including gratuities, received by the taxpayer in the year plus

(a) the value of board, lodging and other benefits of any kind whatsoever...received or enjoyed by him in the year in respect of, in the course of, or by virtue of the office or employment;... [Emphasis added.]

The word "office" is defined in section 139(1)(ab) to mean "the position of an individual entitling him to a fixed or ascertainable stipend or remuneration..." and includes judicial, public and political offices, and the position of a corporation director. "Employment" is defined by section 139(1)(m) to mean "the position of an individual in the service of some other person (including Her Majesty or a foreign state or sovereign)". According to one commentator, "The essence of this definition is the fact that an individual is in the service of some other person, meaning, apparently, that the individual is under that person's direction or control in the performance of his duties". The definition also implies "that there must be a contract of service establishing a relation between them in addition to the element of control". 7/

The words "and other benefits" were held by the Tax Appeal Board in Snell v. M.N.R. 8/ to embrace the advantage arising from a purchase of shares by an employee at less than market price. The scope of this decision is, of course, delimited by the requirement that the benefit, to be taxable, must have been received by the employee "in respect of, in the course of, or by virtue of" the office or employment, that is to say, by way of remuneration for services as distinguished from a testimonial. This

distinction, clearly recognized in both English 9/ and Canadian 10/ decisions, was well expressed by Rowlatt, J. in Mudd v. Collins:

When a man is given a testimonial because of his work in the past, not directly remunerating him for that work, but recognizing how high a regard has been held for him in the association of people with him arising out of the performance of those services, and people recognize the good qualities he has and how zealous and kind he has been and how eager to advance the interests of his employers or his parishioners or his constituents, or whatever they may be, and they say "We would like to give you something as a mark of our esteem and regard", that is a testimonial. But where a man does a business operation of this kind which he could not be called upon to do, but it is a business operation and would have to be paid for handsomely if done by somebody else, and it is said "One of our directors did it for us and he ought to have something besides his fees as director because of this", that seems to me to be paying him for his services.... 11/

An employee may be granted shares or a stock option in his employer company as remuneration for services under various arrangements which result in differing tax consequences. Generally, the problem which arises is twofold, namely to determine (1) the amount of the benefit, and (2) the time when it is realized.

Free Issue of Fully Paid Shares

The simplest case of an issue of shares to an employee attracting tax as being a "benefit" from his employment within section 5(1)(a) would be a free bonus issue or transfer of fully paid shares. 12/ For it is a well-established principle of income tax law that income may take the form of money or money's worth. The time of realization of the benefit would be the time of receipt of the shares, as Parliament has clearly prescribed in section 5 that income from an office or employment arises when it is received, and not before. The allotment of the shares would probably satisfy the requirement of "receipt": see Weight v. Salmon, infra. The

amount of the benefit would likely be the value of the shares to the employee, which would be their fair market value, if the shares were free of any restriction on disposition. 13/

Grant to an Employee of a Privilege, but not a Contractual Right, to Acquire Shares at Favourable Prices

A similar position obtains in circumstances where an employee is given a privilege, but not a legally enforceable right, to make bargain purchases of shares in his employer company. In Weight v. Salmon, 14/ the taxpayer was a managing director of a limited company at a fixed salary. In addition, the directors in each year gave him a privilege of applying for certain unissued shares of the company at their par value, which was considerably less than their current market value. He accordingly applied for shares and they were issued to him. It was held by the House of Lords that the difference between the par and market values was profit in the nature of money's worth received by the taxpayer as remuneration for his services and was includible in his income. The income was realized when the shares were allotted, for as Lord Atkin pointed out, "...while the Board have expressed their willingness to entertain an application for these shares, nobody was bound and no right was given and no profit was received of any kind by the appellant until the application had been accepted and the shares in question had been allotted to him". 15/

Notwithstanding differences in the language of the relevant provisions in the British and Canadian income tax statutes, the decision in Weight v. Salmon was applied by Mr. R.S.W. Fordham in No. 126 v. M.N.R. 16/ where the facts were similar. He followed the latter decision in Snell v. M.N.R. 17/ to hold an employee taxable under section 5(1)(a) in respect of the benefit arising from a bargain purchase of shares.

Grant to an Employee of a Legally Enforceable
Right to Acquire Shares at Favourable Prices

Where an employee is granted a legally enforceable right to acquire shares in his employer company—a stock option—as where he gives consideration for the option, or it is granted under seal, the tax consequences under Canadian law are not entirely clear, either as regards the quantum of the benefit or the time of its realization.

No. 247 v. M.N.R. 18/ is the leading Canadian decision on this important point, and therefore warrants close scrutiny. The appellant was general manager of a corporation, and on May 19, 1951, entered into an agreement, described as an option, with his employer, which provided that the appellant might purchase 45,000 shares at stipulated prices over the next three years. Thirty thousand shares were duly purchased at two different dates in 1952. In giving judgment for the Minister, Mr. Fordham held that the difference between the purchase price paid and the market value of the shares at the date of the option agreement (and not at the date the option was exercised) was includible in the appellant's income as a benefit under section 5(1)(a). He held further that the benefit arising from the exercise of the option in 1952 was to be related back and taxed as income of 1951, when the right was obtained:

...an examination of the authorities indicates that once such an option has been exercised, the advantage thereby gained is deemed to relate back to the time of receipt of the document granting the option. The cases that support this conclusion are well discussed in Hannan and Farnsworth's The Principles of Income Taxation (1952) in Chapter 15. I refer particularly to the judgment of Viscount Simon in Humphrey (H.M. Inspector of Taxes) v. Gold Coast Selection Trust, Ltd. (1948), 30 T.C. 210, at page 238 and on. 19/

The correctness of this decision would seem to be open to question on two counts, first, the quantum of the taxable benefit and second, the year

with respect to which it constituted income. For if, as the learned Board member stated, a valuable right was acquired by the appellant in 1951, it is not clear why he did not hold that the benefit (the value of the option) was received in that year. Certainly he seemed loathe to find that income was realized prior to the exercise of the option. Nor did he explain why the quantum of the benefit to the taxpayer was the difference between the price paid for the shares and their market value at the date of the grant of the option, rather than the difference between the amount paid and the market value at the date of the exercise of the option. He appears to have regarded the difference between the option price and the market value of the shares at the date of the grant of the option as the maximum potential benefit which the appellant could realize, which benefit was realized only to the extent that the option was exercised. Even if we take his view that the benefit arose when he purchased the shares in 1952, it would seem to follow that the gain should have been included in his income for that year, and ought not to have been related back to 1951. Under section 5(1)(a), only benefits "received" or "enjoyed" are includible in income, and there is neither statutory nor judicial authority in Canadian law for so relating income back in the case of income from an office or employment.

Moreover, Mr. Fordham's reference to English authority does not bear analysis. For the general rule under English law is that income arises when it is received. 20/ To this general rule there are two major exceptions. The first is the judge-made doctrine of "relation back of trade receipts", which is applicable only to taxpayers carrying on business. The doctrine was succinctly explained by Viscount Simon as follows: "The principle is to refer back to the year in which it was earned, so far as possible,

remuneration subsequently received, even though it can only be precisely calculated afterwards." 21/ It is based "on a recognition of the method by which traders and others are accustomed to ascertain their profits for any year". 22/ As for the second exception, income from an office or employment arises upon receipt of the compensation, which is then attributed to and treated as income of the period when the services were performed, the tax liability for that period being adjusted accordingly. This tax treatment is prescribed by special statutory provisions 23/ which have no counterpart in the Canadian Income Tax Act. Also Mr. Fordham's reliance on the Humphrey case was misconceived: the case was not an option case; the taxpayer was in business and did not derive income from an office or employment; and there was no question of relating income received in one year back to an earlier year. Finally, if the judgment in No. 247 v. M.N.R. was correct, it would surely be an open invitation to tax avoidance, for an employee would have only to wait for the statutory limitation period to pass before exercising his option; the gain would be related back to the year in which the option was granted, and if more than four years had elapsed, it would be out of time for assessment. However, for the foregoing reasons, the decision may well be incorrect.

This conclusion is supported by the recent decision of the House of Lords in Abbott v. Philbin. 24/ In that case, the company, of which the appellant was secretary, offered to its executives in 1954 options to buy a number of its unissued shares at 68s. 6d. per share, which was then the market price. The options were not transferable and were to expire after ten years or on the earlier death or retirement of the appellant. The price of the option was £1 per 100 shares, and in October 1954, the appellant acquired an option on 2,000 shares for which he paid £20. The market price

rose and, in 1956, when the price was 82s., the appellant exercised his option to the extent of 250 shares and acquired them at 68s. 6d. If he had immediately sold those shares he would have made a profit of £166. He was assessed on this sum, less a proportionate part of the price of the option, for the year 1955-56 under Schedule E, Rule 1 of which charged tax in respect of all "salaries, fees, wages, perquisites or profits whatsoever" from an office or employment of profit. It was agreed by the parties that the appellant had received something which came within the words "perquisites or profits whatsoever". The appellant contended that the option was the perquisite, and admitted that he was liable to be assessed for the year 1954-55 in respect of the value of the option when it was granted, minus the price he paid for it. On the other hand, the Crown maintained that he received no perquisite in 1954, the perquisite being the shares which were allotted to him when he exercised the option, with the result that he was taxable in respect of the £166.

By a majority of 3-2, the House of Lords gave judgment for the taxpayer and, for two main reasons, held that the option was itself a perquisite or profit arising from the office at the time of the grant. First, applying the principles laid down in Tennant v. Smith 25/ that only money or that which can be turned to pecuniary account is includible in income, the majority was of the view that the option was a valuable right which the taxpayer could have converted into money and was analogous for tax purposes to any other benefit in the form of land, objects of value or legal rights, and this, notwithstanding that the option was not transferable. He might, for example, have arranged with a third party to exercise the option and transfer the shares to him, even though he could not have placed the third party into his own position as option holder against the company. The fact

that the option was not transferable might have reduced its value but could not alter its nature. And if the option had no ascertainable monetary value as at the date of grant, then it was a perquisite of no value and there was nothing to tax, and that was the end of the matter.

Secondly, the advantage which arose by the exercise of the option was not a perquisite or profit from the office in the year of assessment, as it must have been to fall within the terms of the statute, but rather accrued to the appellant as holder of a legal right which he had obtained in an earlier year and which he exercised as option holder against the company. That is to say, the company "gave" him nothing in 1956; it merely satisfied a previously created legal obligation. The increase in the market value of the shares was due to numerous factors which had no relation to the office of the employee or his employment in it, such as "...retention of profits, expansion of business, changes in the nature of the business, even changes in the market conditions or the current rate of interest or yield". 26/ In Lord Radcliffe's opinion, "...it would be quite wrong to tax whatever advantages the option holder may obtain through the judicious exercise of his option rights in this way as if they were profits or perquisites from his office arising in the year when he calls the shares". 27/

The two dissenting judges held that the income arose only when the option was exercised. The option was only a standing offer, said Lord Keith, and since it was not transferable, only on its exercise did a benefit arise to the taxpayer. If an option were freely transferable or renounceable in favour of third parties, then an employee who sold his rights to a third person for a genuine and not a fictitious price would, in effect, have

secured a benefit equivalent to what he would have received if he had applied for the shares to be registered in his own name and would be taxable. In short, until accepted or otherwise dealt with in accordance with its terms, an offer cannot be regarded as securing for the servant a profit from his employment.

In Lord Denning's opinion, the option was merely a right to make profits in the future, and an expectation of receiving profits, no matter how well founded, was not itself a perquisite or profit. "A bird in the hand is taxable", he said, "but a bird in the bush is not". 28/ Moreover, the option could not be likened to a physical thing such as a diamond, or to a chose in action such as a share or bill of exchange which were by nature assignable; for all of these were interests in property and were very different from purely personal rights, such as the option in question.

The tax avoidance possibilities of Abbott v. Philbin remain to be considered. It follows from the judgment of the majority that if, at the time of grant of an option, it cannot be turned into money, it is not includible in income at that time. Hence, if an employer company attached a condition prohibiting the employee from selling his option, or raising money on it, or dealing with it otherwise than by exercise of it, and stipulated that if the employee breached the condition the option would be cancelled, the employee would realize no income at the time of receipt of the option. It is possible that something less than such a specific condition would be sufficient to preclude an option from being income—for example, if the employee could raise money on the option only at the risk of impairing good relations with his employer. This point was left open by Lord Reid who did state, however, that conditions and restrictions to which an option was subject would have a material bearing on the value of

the option, but were only relevant on the question of whether the option was taxable as a perquisite if they would in law or in practice effectively prevent the holder of the option from converting it. Hence, if the option was not convertible when received, and if, as the majority held, the subsequent increase in the value of the shares was attributable to factors other than the office or employment and so was not within the language of the statute, the gain arising to an employee from the option and its subsequent exercise would escape tax altogether. This possibility was explicitly recognized by Lord Radcliffe, one of the majority judges, when he said:

It is a natural enough assumption for the tax gatherer that if a transaction does not attract tax in one year it must in another. I do not myself, however, regard that as a good general principle upon which to found the construction of the Income Tax code. Considering that, at any rate since the decision of this House in Tennant v. Smith..., it has been necessary to put a somewhat restricted meaning upon the words "all salaries, fees, wages, perquisites or profits whatsoever"..., I should not be surprised to find that neither an option to take up shares at a price, more particularly perhaps if the option is made non-assignable, nor the advantage obtained later from exercising the option, comes within the range of those words. 29/

Canadian courts, on similar facts, would very likely reach the same result as did the majority. A legally enforceable contractual right would seem clearly to fall within the elastic concept of "benefit" in section 5(1)(a) and, when granted in circumstances similar to those in Abbott v. Philbin, also within the words "in respect of, in the course of or by virtue of the office or employment". Furthermore, although Canadian courts have not yet come to grips with interpreting these latter phrases, it seems probable that they would follow a line of reasoning similar to that taken by the majority and hold that increases in the value of stock that were attributable to factors such as retention of profits and expansion of business could not be said to have been received "in respect of, in the

course of or by virtue of the office or employment". In summary, then, the employee would be taxed in respect of the value of the option, less what he paid for it, in the year of the grant of the option.

Acquisition of Shares Pursuant to a Stock-Purchase
Plan Under Which Payment for Shares is Made Over
Two or More Taxation Years

An employer company may confer on its employees a privilege, but not a legally enforceable right, of purchasing shares at a price below market value, permitting payment for the shares to extend over two or more taxation years, perhaps by deductions from the employees' salaries and wages. The issue that arises in these circumstances is whether the benefit arises (i) when the employee elects to buy the shares, (ii) when he completes payment for the shares, (iii) when the shares are issued by the company, or (iv) when the shares are received by the employee, the amount of the benefit being the difference between the option price and the value of the shares at the respective dates of these various events.

The issue arose for consideration in Bentley v. Evans. 30/ In a prospectus issued on October 1, 1953, employees of a Canadian company and its subsidiaries were offered shares in the parent company at a price 15 per cent below the then market price. Under the terms of the offer the purchase price of the shares was payable by instalments, which, in the absence of other arrangements, were recoverable by deductions from pay. At the end of any month in which the parent company had received sufficient funds to pay the purchase price of 3 shares (or such lesser number as was required to complete the total number the employee had undertaken to buy) the company would issue the shares and deliver the share certificate to the employee. An employee was free to dispose of any shares which had been

fully paid up and issued to him. The taxpayer, the secretary of one of the subsidiary companies, elected on October 7, 1953, to buy 15 shares, to be paid for by means of deductions from his pay. He received 3 shares in each of the months of March, July and October, 1954, and in November, 1954, he paid cash for and received his 6 remaining shares. The taxpayer contended that the right to the shares was acquired by him on October 7, 1953, and that the profit arising to him should be calculated by reference to the difference between the market price on that date and the price which he paid for the shares. For the Crown it was contended that in calculating the profit, the market prices when he received the shares, that is, in March, July, October and November, 1954, respectively, should be taken into account. Roxburgh, J., after emphatically pointing out that cases bearing on the taxability of benefits arising from stock options were totally inapplicable to the question before him, gave judgment for the taxpayer, and held that the advantage to the taxpayer was a perquisite of his employment in the form of money's worth which arose when he elected to purchase the shares on October 7, 1953: "...the Respondent on that date received the pecuniary advantage of the perquisite, because it was only by virtue of the perquisite that he was able to bind the parent company to allot him those shares at that reduced price". 31/

Although this judgment was delivered before the decision of the House of Lords in Abbott v. Philbin, it seems plain that the requirement so much emphasized by the majority of their Lordships in that case, namely, that the benefit alleged to constitute income must be convertible into money, was satisfied in Bentley v. Evans, since the shares which the taxpayer elected to purchase could have been prepaid at any time and were freely transferable when paid in full and issued.

On similar facts, Canadian courts would very likely reach the same conclusion under section 5(1)(a).

Acquisition by an Employee of Shares or a Stock
Option from Someone Other than the Employer Company

Instead of acquiring shares or a stock option directly from the company for which he works, an employee may arrange to obtain these benefits from a major shareholder of the company or from a subsidiary or related company. ^{32/} If the benefit is granted as a testimonial, it will not be taxable: Bridges v. Bearsley, ^{33/} where shares granted to an employee by major shareholders in his employer company purely as an act of bounty were held not taxable; but if granted as compensation for services, it is includible in income: M.N.R. v. Tomkins, ^{34/} where the advantage arising to an employee from a bargain purchase of shares in his employer company from a major shareholder therein, pursuant to an option, was held taxable to the employee.

Benefits of a compensatory nature may arise in situations similar to those already discussed:

- (a) the employee might be given a parcel of shares outright, in which case he would be taxable in respect of the fair market value of the benefit in the year the shares were received;
- (b) the employee might be permitted, without being granted a legal right, to buy shares at less than fair market value, in which case he would be taxable, as in Weight v. Salmon, on the amount of the difference between what he paid and the fair market value of the shares at the time of purchase, in the year he acquired the shares;

- (c) the employee might be granted an enforceable right to acquire shares, in which case he would be taxable, according to Abbott v. Philbin, on the value of the option in the year it was granted; and
- (d) the employee might agree to purchase shares and pay for them over a period of time, in which case he would be taxable, as in Bentley v. Evans, on the value of the benefit at the time he contracted to purchase the shares.

SCOPE AND EFFECT OF SECTION 25

Section 5 must be read in conjunction with section 25, which provides that certain amounts paid by an employer to an employee, or potential employee, which might not otherwise be taxable, shall be deemed for the purpose of section 5 to be remuneration for the payee's services rendered during the employment. Section 25 applies to amounts received during a period when the payee was employed by the payer, or received on account or in lieu of or in satisfaction of an obligation arising under an agreement made between them immediately before, during or immediately after a period of employment; unless the payee can affirmatively establish that the amount cannot reasonably be regarded as having been received (i) in return for entering into the contract; (ii) in return for services under the contract; or (iii) in return for a covenant relating to what the employee is, or is not, to do before or after the termination of the employment.

Testimonials would not, of course, fall within the ambit of this section, but the value of shares or of a stock option granted by a company to induce the recipient to become its employee would be taxable to the employee, as would similar benefits received by the employee as consideration for a restrictive covenant governing his activities after the termination of his employment.

Canadian courts have never considered whether the language of section 25 is broad enough to include in the income of an employee, who acquires shares under a legally enforceable option, the increase in the value of the shares between the time the option was granted and the time it was exercised. That is to say, if a company were to grant an option to a taxpayer to induce him to become an employee, and the taxpayer accepted the employment and subsequently exercised the option to his advantage, the value of the option at the time it was granted would be taxable, but would the subsequent increase in the value of the shares up to the date he exercised the option be includible in his income? It is unlikely that such a gain would fall within section 25, since the employee would have acquired the shares in his capacity as option holder exercising legal rights against the company which conferred the benefit on him at the time it granted the option. On the exercise of the option, to use the language of Abbott v. Philbin, the advantage would accrue to the taxpayer "as the holder of a legal right which he had obtained in an earlier year, and which he exercised as option holder against the company". 35/

THE PROBLEM OF VALUATION

If the employer is a public company whose shares are traded on a stock exchange, the problem of valuation is minimal when an employee acquires shares in the company either gratuitously or under a bargain purchase, since the gain would simply be based on the market value at the time of receipt or allotment. However, the problem of putting a price on shares in a private company or in a public company whose shares are unlisted, is notoriously difficult, 36/ and is further complicated when conditions and restrictions on alienation are attached to the shares, as occurred in Ede v. Wilson. 37/

In that case, shares in a parent company were purchased at less than market value by employees of a subsidiary company, who gave the required verbal undertaking not to sell such shares without the permission of the directors of the parent company so long as they remained in the employ of the subsidiary. It was held that the benefit arising from the bargain purchase was taxable since the shares could have been turned into money either through sale with the consent of the parent company, or without such consent, although in the latter case the seller would have exposed himself to the displeasure of the board, possibly even to dismissal. With respect to the worth of the benefit, Wrottesley, J. stated that it was for the Commissioners to say whether any, and if so, what, reduction ought to be made in the assessment in view of the restriction on disposition. He explained that the value of the shares would vary according to the personal circumstances of the recipient: "Thus, to a man not likely to need to sell them, they will doubtless hold their full value as on the stock exchange. To a man who has no other capital they may possibly have a lesser value;... [The value] may be very different in the hands of different persons.... To a well-to-do person with capital of his own already it may be worth the stock exchange value; to another man it may not". ^{38/} Thus, if five executives acquired an equal number of shares which were subject to restrictions on alienation, theoretically five different valuations could be placed on their respective benefits because of variations in their personal circumstances. This approach obviously poses an administrative problem of considerable magnitude. Some doubt as to the correctness of his Lordship's remarks appears to have been entertained in the lower court in Abbott v. Philbin, ^{39/} where Roxburgh, J. said: "If that is good law... there may be some interesting and protracted valuations if they are conducted

on the lines indicated by Wrottesley, J." The House of Lords in the Abbott case gave little instruction on how to value the option there in question, other than to say that conditions and restrictions should be taken into account. Exceedingly difficult indeed is the problem of fixing the value of a stock option which is not transferable, which may be exercised over a period of years, and which contains a stipulation that shares acquired under it must be held for a certain period. The decision in Abbott v. Philbin prompted one observer to speculate that remedial legislation would shortly be enacted to resolve the valuation difficulty to which that decision gave rise, 40/ but to date, no such legislation has been passed.

It may be noted in passing that Mr. Fordham held in No. 126 v. M.N.R. 41/ that a moral obligation on the part of an employee not to dispose of shares acquired under a bargain purchase was not to be taken into account in valuing the benefit. Nor did he attach any weight, in No. 247 v. M.N.R., 42/ to a restriction on disposition of the shares acquired by an employee under an option, which restriction he thought was more fancied than real, and, in any event, was not of long duration.

NATURE OF THE GAIN OR LOSS REALIZED ON THE SALE OF THE SHARES

The gain or loss realized by an employee on the sale of shares acquired as remuneration from the employer company or from a shareholder in the company would seem clearly to be of a capital nature, unless, perhaps, the employee was also in the business of dealing in shares. Lord Reid commented in Abbott v. Philbin: "...it is not suggested that further appreciation after shares have been allotted can be taxed". 43/ In No. 103 v. M.N.R. 44/ the appellant was a conveyancer who dealt in real estate transactions, searched titles, arranged mortgages and lease agreements

and managed properties. He did work for a client and rendered a bill for his services for approximately \$200. Eventually, to settle the account, he accepted a transfer of the client's interest in a stock option agreement with a mining company, under which the client was entitled to purchase shares in the company over a period of time at fixed prices. Shares in the company later increased in value and the appellant exercised the option and sold the shares at a profit. The Income Tax Appeal Board held that the appellant was not in the business of buying and selling shares and that the profits realized were capital gains and not taxable.

One writer, however, appears to take the view that the gain arising on the disposition of shares is taxable under section 25:

Prior to enactment of s. 25, a benefit received by an employee represented by the price spread between current market value of stock acquired under option, at the date of option, and sale price at the date of disposition, was a tax free capital gain. [No. 103, 53 DTC, 204; 8 Tax A.B.C. 287]. Hence, "above option-date market value" profits derived from stock options entered into prior to 1949 were treated as capital profits. Since 1948, s. 25 has been in force, and its application was apparently broad enough to provide for inclusion in computing income of "above market value" stock option profits if the stock option under review was originally granted to the employee as compensation. In such a case, although the stock option is worthless to the employee when it is given, it confers a future right based upon the contingency of an increase in the market value of the stock to receive a profit based upon the difference between future and past market value. Because such contracts normally would not be received by employees but for their employment, profits earned are income from employment. [Snell, 57 DTC 299; 17 Tax A.B.C. 186]. 45/

The correctness of the reasoning in this statement is open to question. As was pointed out in the discussion of Abbott v. Philbin, supra, the rise in the value of stock between the date the option is given to an employee and the date he exercises it is not remuneration granted by the employer, but arises independently of the office or employment from a host of outside factors which influence the value of shares, some of which factors were

enumerated by Lord Radcliffe in Abbott v. Philbin, and quoted supra at page 141. A fortiori is this the case with respect to the rise in value of shares which occurs after the employee has acquired them. He realizes the gain not in his capacity of employee but as a shareholder disposing of his investment. In the sale transaction his employer plays no part. Moreover, merely because the taxpayer would not have been granted the option under which he acquired the shares which he sold at a profit "but for" the employment does not mean that the gain realized on their sale is taxable. For the fact that a nexus exists between the gain and the employment is in itself insufficient to give the gain the quality of compensation or remuneration for services, as was made plain by Rand, J. in the leading case of Goldman v. M.N.R.:

Contrasted with such a payment [a payment for services rendered] is a benefaction of an exceptional kind such as a testimonial or other personal tribute, the antecedent instigation of which has been an office or employment. There the essential elements of gift are present; and though it may be related to the fact of services, it is not as remuneration for them that the gift is attributed.
[Emphasis added.] 46/

TAX TREATMENT OF THE EMPLOYER COMPANY

Although an employee may be taxable in respect of the pecuniary advantage arising to him from a bargain purchase of shares in his employer company, it does not follow that the company will be entitled to deduct the amount of the advantage in computing its profits, for taxability to the employee and deductibility to the employer are not necessarily correlative. As the eminent British tax authority, the late Dr. A. Farnsworth, has pointed out, "...many cases, moreover, can be brought to mind where an employee's emoluments from his employment in no way represent a loss to his employer, e.g., tips". 47/

Indeed, it has been held by the House of Lords that a company is not entitled to deduct for tax purposes the difference between the price paid by its employees for shares in the employer company and their market value at the date of purchase. In Consolidated African Selection Trust Ltd. v. Lowry, 48/ a company issued at par to certain employees, in consideration of services, a number of its ordinary shares. The market value of the shares was considerably above par. In computing its profits for income tax purposes, the company sought to deduct the difference between the market price and the price paid by the employees as being "expenditure" in the nature of remuneration for services rendered in the course of its trade. The House of Lords, reversing a unanimous decision of the Court of Appeal, held by a majority of 3-2 that the deduction was not allowable. The Court of Appeal had taken the view that since the excess value of the shares was, according to the decision in Weight v. Salmon, remuneration of the company's employees, it must therefore be an expense of the company which it had incurred by forbearing to issue the shares at the full price obtainable, and thus forgoing the cash value of the premiums; the receipt by the employees of remuneration presupposed a payment of some kind by the company. With this view the minority of the House of Lords substantially agreed. The majority, however, rejected the reasoning that just because the company had failed to use an opportunity to secure some financial advantage, it had therefore suffered some financial detriment or incurred an expense. In their Lordship's opinion, forbearing to make a profit was not the same thing as incurring an expense, and the company was not entitled to make up its accounts as if it had sold the shares at the full price obtainable and had then made a payment to its employees, when, in fact, it had elected to issue the shares at par, a course which did not involve it in any expenditure of money or realization of its assets.

The majority decision turned in large part on the nature of the right of a company to issue shares. According to Lord Russell, "The power of a limited company to issue and allot shares is not an asset of the company; it is only a power to increase its issued capital and, it may be, the number of corporators. It is not bound to issue its shares for more than their nominal value". 49/ He quoted with approval, as did the other two majority judges, the following passage from Hilder v. Dexter:

I am not aware of any law which obliges a company to issue its shares above par because they are saleable at a premium in the market...the benefit to the shareholder from being able to sell his shares at a premium is not obtained by him at the expense of the company's capital. 50/

Hence, when the company issued the shares at par, it did not part with or transfer any asset in money or money's worth. True, the employees were getting an advantage of considerable value but, the majority concluded, they were not getting it in any true sense at the expense of the company, though, no doubt, the company had forgone the chance of making a profit.

Section 85A

In 1953 Parliament enacted what is now section 85A of the Income Tax Act, which deals specifically with the taxation of benefits conferred on employees through stock option and stock purchase agreements between a corporation and its employees. From time to time the section has been amended and expanded. It was designed to plug a loophole which was thought by Parliament to exist in the law with respect to stock option and stock purchase plans. The then Minister of Finance, the Honourable D. C. Abbott, in discussing the purpose of the section, stated: "...it was felt that it was necessary to prevent an abuse of these stock option devices through

allowing employees, perhaps executives of a corporation, to get very large benefits which would not be taxable". 51/ Although intended as a measure to frustrate tax avoidance, the section actually fosters it, providing as it does for the taxation of unlimited stock option benefits at a significantly lower rate of tax than would apply if the amount of such benefits were taxed as ordinary income. As Mr. J. O. Weldon of the Tax Appeal Board said recently, "The said section provides a substantial advantage to the taxpayer who can bring himself within its provisions". 52/

SCOPE AND EFFECT

The most important features of the section are as follows:

- (a) It is applicable where "a corporation has agreed to sell or issue shares of the corporation or of a corporation with which it does not deal at arm's length to an employee of the corporation or of a corporation with which it does not deal at arm's length".
- (b) Any benefit deemed to arise under the agreement is removed from the general treatment under section 5(1)(a) by section 85A(5) which provides that the employee will be deemed not to have received any benefit except as provided in section 85A.
- (c) No deduction for tax purposes is allowed a corporation on account of a benefit conferred on an employee.
- (d) A benefit will be deemed to have been received by the employee by virtue of his employment if he realizes the worth of his rights in any of four ways:

- (i) Where the employee acquires shares under the agreement.

In this case the benefit is the excess of the value of the shares at the time he acquires them over the amount paid or to be paid by him to the corporation for the shares. The benefit is deemed to have been received in the year in which the shares are acquired, regardless of when payment for the shares is to be made.

- (ii) Where the employee transfers or otherwise disposes of rights under the agreement to a person with whom he was dealing at arm's length.

In this event, the benefit deemed to have been received equals the value of the consideration for the disposition, and is deemed to have been received in the taxation year in which the employee made the disposition.

- (iii) Where the employee's rights under the agreement have, by one or more transactions between persons not dealing at arm's length, become vested in a person who has acquired shares under the agreement.

In these circumstances, the benefit equals the excess of the value of the shares at the time they are acquired by the transferee of the employee's rights over the amount paid or to be paid by that person to the company. Thus, an employee is taxable if he transfers the rights to his wife, child, parent or other person with whom he does not deal or is deemed not to deal at arm's length. This benefit is deemed to have been received in the taxation year in which the transferee acquired the shares.

- (iv) Where the employee's rights under the agreement have, by one or more transactions between persons not dealing at arm's length, become vested in a person who has transferred or disposed of the rights to a person with whom he was dealing at arm's length.

In this event, the benefit equals the value of the consideration for which the rights were thus finally disposed of at arm's length. A benefit will be deemed to have been received in the taxation year in which that disposition was made. Thus, an employee is taxable where he transfers rights to, say, his wife or child, who then sells them to another person in an arm's length transaction as, for example, on the stock market.

The application of these provisions involves, of course, a determination of whether persons are dealing at arm's length. Subsections (5) and (6) of section 139 of the Income Tax Act set out in detail the circumstances in which persons are deemed not to deal at arm's length.

- (e) Where a share is held by a trustee in trust for an employee, either absolutely, conditionally, or contingently, the employee is deemed to have acquired the share at the time the trustee commenced to so hold it for him. The amount of the benefit will be calculated with reference to the value of the share at the time the trustee acquired it from the corporation. Hence, it is possible for an employee to be taxed on a benefit which he never receives as, for example, where shares are held by a trustee for delivery to the employee only in the event that he remain in the employment for a stated period and the employee severs his employment before the end of that period.

Where shares of the employer or of a corporation with which the employer does not deal at arm's length are sold to a trustee under an arrangement by which they are to be held in trust for sale to employees, the same consequences will follow on a purchase by the employee from the trustee or in a transfer by him of his rights, as if the employee had dealt directly with the employer. The amount of the benefit will be calculated by reference to the value of the shares at the time he acquired them from the trustee.

- (f) If an employee does not realize his option by any of the four methods above described until after he has left his employment, he will be deemed to have received a benefit under section 85A as though he were still an employee.
- (g) Section 85A does not apply if the benefit conferred under the agreement was not received in respect of, in the course of or by virtue of the employment. "Thus if a shareholder who is an employee receives rights issued to all shareholders, in his capacity of shareholder, he would not come within the provisions of section 85A". 53/
- (h) An employee who is deemed to have received a benefit under section 85A may elect to compute his tax for the year according to a formula contained in that section. If no election is made, the employee will be subject to tax on the benefit at his normal rate for the year in which he is deemed to have received it.
- (i) If such an election is made, the rate of tax applicable is the employee's effective average rate of income tax for the three immediately preceding taxation years, excluding provincial, foreign

or dividend tax credits; in the calculation of the three-year average tax rate, benefits from stock options exercised during those years are excluded from the calculation. Twenty per cent of the amount of the benefit may then be deducted from the tax determined under this formula. If the employee's effective rate of tax in those years was less than 20 per cent, he will not be subject to any tax on the benefit which he is deemed to have received. An employee who was not resident in Canada for the three immediately preceding taxation years may determine the average rate of income tax which he would have paid had he been resident in Canada throughout those years.

Example 1:

In 1962, an employee acquired from his corporate employer shares in the company having a market value which exceeded the cost to the employee by \$10,000. His income for each of the years 1959 to 1962, inclusive, was a salary of \$12,000. His annual personal exemption was \$2,000.

	<u>Income</u>	<u>Income and Old Age Security Tax Payable</u>	<u>Calculation of Appli- cable Tax Rate</u>
	\$	\$	%
1959	12,000	2,175	
1960	12,000	2,260	Three-year average: 18.59
1961	<u>12,000</u>	<u>2,260</u>	Deduct: <u>20</u>
	36,000	6,695	Applicable Rate: Nil

If the deemed option benefit were taxed as ordinary income in 1962, \$4,150 tax would have been payable in respect of it.

Example 2:

In 1962, an employee was deemed to receive a stock option benefit of \$10,000. His income for each of the years 1959 to 1962, inclusive, was \$30,000. His annual personal exemption was \$2,000.

	<u>Income</u>	<u>Income and Old Age Security Tax Payable</u>	<u>Calculation of Appli- cable Tax Rate</u>
	\$	\$	%
1959	30,000	9,895	
1960	30,000	10,160	Three-year average: 33.57
1961	<u>30,000</u>	<u>10,160</u>	Deduct: <u>20</u>
	90,000	30,215	Applicable Rate: 13.57
1962			
Salary	30,000	10,160	
Option Benefit	<u>10,000</u>	<u>1,357</u>	
	40,000	11,517	

If the deemed option benefit were taxed as ordinary income in 1962 \$5,000 tax would have been payable in respect of it.

Example 3:

In 1962, an employee was deemed to receive a stock option benefit of \$10,000. His income for each of the years 1959 to 1962, inclusive, was \$100,000. His annual personal exemption was \$2,000.

	<u>Income</u>	<u>Income and Old Age Security Tax Payable</u>	<u>Calculation of Appli- cable Tax Rate</u>
	\$	\$	%
1959	100,000	49,395	
1960	100,000	50,360	Three-year average: 50.38
1961	<u>100,000</u>	<u>50,360</u>	Deduct: <u>20</u>
	300,000	150,115	Applicable Rate: 30.38
1962			
Salary	100,000	50,360	
Option Benefit	<u>10,000</u>	<u>3,038</u>	
	110,000	53,398	

If the deemed option benefit were taxed as ordinary earned income in 1962, it would have been subject to a marginal rate of 65 per cent and \$6,500 tax would have been payable in respect of it.

There are several matters relating to the scope and effect of section 85A which warrant comment.

- (a) Section 85A does not apply to benefits arising under agreements made before March 23, 1953.
- (b) In order to fall within section 85A, the benefit arising to an employee through the acquisition of shares in his corporate employer must have been conferred by the corporation (or a related corporation) and not by a third party, such as a major shareholder of the corporate employer, according to the recent decision in M.N.R. v. Tomkins. 54/ The Exchequer Court held that where certain shares (or the proceeds of sale thereof) were made available to the employee out of the personal property of the president of the corporate employer, the benefit could not be brought within section 85A.
- (c) Section 85A would not appear to apply to a benefit arising under an agreement for the acquisition of shares made by a taxpayer and a corporation before the taxpayer became an employee of that corporation, for the opening paragraph of the section provides that "Where a corporation has agreed to sell or issue shares of the corporation... to an employee of the corporation...." Cameron J. seemed to incline to this view in M.N.R. v. Tomkins, where he said:

...the respondent in this case must establish that Aggregates [the corporate employer] had agreed to sell or issue shares of that company to him, an employee thereof. For the purposes of this case, I shall assume (without deciding) that the respondent was an employee of Aggregates, although it is clear that at the time he entered into the agreement he had not then entered its service but agreed to do so later, and in fact did so. 55/

If this interpretation of the section is accurate, it would be in the interests of a taxpayer contemplating employment with a corporation to secure a legally enforceable right to purchase shares in that corporation before accepting employment. If the option price was the same as the then market price, there would be little or nothing to tax under section 25; if the shares subsequently rose in value and he exercised his option, the gain would not be taxable under section 85A or probably under section 5(1)(a), according to the principle laid down in Abbott v. Philbin.

- (d) Section 85A would not appear to apply to a gratuitous benefit conferred on an employee by his corporate employer in the form of a bonus issue of shares in the employer. For section 85A contemplates an agreement between the employee and his corporate employer, and the acquisition of shares "under the agreement". The Tax Appeal Board took this view in the recent case of Fowler v. M.N.R., 56/ where it was held that shares in General Motors which were transferred to an employee under a voluntary plan for granting bonuses were not transferred pursuant to an agreement to sell or issue shares within section 85A.
- (e) Section 85A(1)(a) provides that "if the employee has acquired shares under the agreement", he is deemed to have received a benefit "in

the taxation year in which he acquired the shares" equal to the difference between the value of the shares" at the time he acquired them" and the amount paid or agreed to be paid for them. The word "acquired" in this context (and in paragraph (c) of section 85A(1)) may contemplate the acquisition of beneficial ownership or title to the shares, so that an employee who has entered into a stock-purchase agreement, but to whom shares have not been allotted or issued, has a right to acquire title to the shares but cannot be said to have "acquired shares". This view is quite consistent with the words "paid or to be paid", for it is quite possible for shares to be issued to an employee before he has paid for them. It has been held that an employee receives a perquisite at the time he makes a binding commitment to purchase shares at a bargain price—see Bentley v. Evans, supra, at page 144—but section 85A(1)(a) is satisfied only if the employee has "acquired shares". The possible adverse tax consequences to the purchasing employee were the subject of the following critical comment by a committee of tax experts:

It would appear that in the case of a purchase agreement an employee may be subject to successive impositions of tax on purchases of shares in due course, being taxed in effect as an investor with respect to capital gains, and not as an employee with respect to the benefit of his agreement with his employer at the time he entered into it. 57/

The Committee on Income Tax Bill 228, which introduced section 85A, was made up of lawyers, accountants and members of the staff of the Canadian Tax Foundation, and transmitted its remarks to the Minister of Finance in a memorandum dated March 31st, 1953, over the signature of the Executive Director of the Canadian Tax Foundation, Mr. Monteath Douglas. The Committee recommended that:

In the case of a stock-purchase agreement, the value of the benefit should be determined by reference to the price at which the employee makes a commitment to purchase in relation to the value of the stock at the time he becomes so committed....

In every case there would then be a single point of determination, and the taxpayer would have full knowledge of the factors determining his tax liability at the time he incurs it. Any subsequent advantage or disappointment depending on the future value of the stock is irrelevant to the taxable transaction, because it concerns the taxpayer's experience as an investor and does not concern his contractual relationship with his employer. 58/

- (f) An employee who has entered into an agreement with his corporate employer as contemplated by section 85A may be able to realize his benefits by means not covered by that section. He might, for example, use his rights as security for a loan, or make a gift of them to charity, thereby becoming entitled to a charitable deduction without having laid out a penny.

REASONS FOR THE REDUCED RATE ON STOCK OPTION BENEFITS

The special tax rate formula described above did not appear in the 1953 amending bill, which contained a somewhat different scheme for taxation, namely, that where an employee acquired shares under an agreement with his corporate employer, the benefit he was deemed to receive was "the amount by which 95% of the value of the shares at the time he acquired them exceeds the amount paid or to be paid to the corporation therefor". This benefit was taxable, if the employee so elected, at the average rate of tax paid by him during the three immediately preceding years. The Committee on Income Tax Bill 228 59/ said of this scheme of taxation, "...we welcome the method of taxation provided in subsection (2)". 60/ The Minister of Finance, the Honourable D. C. Abbott, explained the rejection of the original proposal as follows:

...when we examined the facts in connection with some of these employee ownership plans it seemed that we had been unduly strict in the original proposal here, and that it might interfere with the operation of long-standing employee stock ownership plans which had been carried on for years. 61/

In its place was substituted what Mr. Abbott described as the "considerably more generous" provisions contained in section 85A, which worked two major changes: first, the imposition of tax on the whole of the benefit rather than on just part of it, and secondly, the reduction of 20 per cent from the average rate of the three preceding years. No explanation was offered for the selection of the three preceding years for determining the average rate rather than two years, or four years, or some other number, such as the period over which the gain accrued. The reduction of 20 per cent was explained as follows:

I might explain why this 20 per cent abatement against tax appeared to be a reasonable degree of relief. Section 5 of the law, while defining generally the scope of the tax on wages and salaries, provides that certain of what I might call fringe benefits need not be included in income. For example, the benefits obtained under group insurance plans need not be included in income. Neither is the employee required to include in his income the dollar value of his benefits under medical service plans. These facts suggest that it would not be unreasonable to exclude by some device moderate benefits received under stock purchase plans, for example. 62/

And further at the same page:

A further point in this connection is that although the benefits received by the employee under stock purchase or stock option plans are regarded as income from office or employment, that is, it is regarded as remuneration, the corporation providing remuneration in this form to its employees does not charge it against its profit and loss account for purposes of corporation income tax. Thus it might be said that we are getting corporate income tax in a larger amount because the corporation decides to benefit its employees in this way.

These facts suggest that a degree of abatement equal to the low bracket of corporate tax might be a reasonable measure of relief to adopt. Accordingly, as I stated above, the tax as calculated on the effective average rate for a three year period will be reduced by 20 per cent, which is the minimum rate of tax on corporations.

He went on to say:

I think it is quite appropriate that a corporation should offer its stock to employees at a price which is appreciably below the going market value because those values fluctuate. There is a certain amount of risk involved, and it is a way in which employees can obtain a benefit. So long as that is not excessive I do not think we should attempt to tax that modest benefit, because it is not charged by the corporation as an expense. 63/

UNITED STATES TAX TREATMENT OF STOCK OPTION BENEFITS

Before 1964, only one type of employee stock option, the "restricted stock option", was accorded special, favourable tax treatment, under legislation enacted in 1950. Two new classes of stock options have been given special tax treatment by the Revenue Act of 1964—the "qualified stock options" (those issued to key employees), which are subject to much stricter rules than the "restricted stock options", and options issued under an employee stock purchase plan, which are governed by rules similar to those for "restricted stock options", with some modifications. A fourth class of stock options, those for which no special statutory treatment is prescribed, is taxable under the general rules of the income tax. These "ordinary stock options" may conveniently be dealt with first.

Ordinary Stock Options

Prior to the decision of the Supreme Court in Commissioner v. LoBue 64/ in 1956, the tax treatment of stock option benefits was obscured by the controversy over whether such benefits constituted additional compensation and so were taxable, or whether they were granted to employees in order to provide them with a "proprietary interest" in the business, and so were not to be considered compensatory. Judicial decisions were divided on this question. In the LoBue case, the Supreme Court held that the "proprietary

interest" test had no basis, and that the stock options there in question, not having been granted as "gifts" within the exemption provision in the statute, were compensation which was taxable under the former version of section 61(a) of the present Internal Revenue Code, which defined gross income as including "gains, profits, and income derived from...compensation for personal service...of whatever kind and in whatever form paid".

As to the questions of when an option gives rise to a benefit and the measure of the benefit, it has been held that an employee to whom an option has been granted may realize an immediate taxable gain upon receipt of the option, 65/ provided it has a "readily ascertainable market value", a condition which would appear to be satisfied only if the option is transferable. In the LoBue case, the options were not transferable by the employee, and his right to acquire shares under them was contingent upon his remaining an employee of the company until they were exercised. The Court held that the employee realized a taxable gain not at the time of the grant of the option but rather at the date of its exercise. The United States rule may be contrasted with the decision in Abbott v. Philbin, where the House of Lords held that the restriction on transfer of an option did not preclude the option from being a taxable perquisite but was only a factor to be taken into account in determining its value.

United States law on the subject is complicated by yet another problem, the valuation of the stock when the option is exercised by the employee. It was held in one case that stock received on the exercise of an option did not have a fair market value at all because of limitations on its sale. 66/ In other cases, such limitations have merely resulted in lower valuations being placed on the stock. The United States approach

to this problem may be contrasted with the rule laid down by the English courts in Ede v. Wilson, where a clog on the right to sell the stock acquired through the exercise of an option was held to be a matter to be taken into account in determining the value of the stock.

United States law on the tax treatment of ordinary stock options has been summed up as follows:

In general, nonstatutory employee stock options are taxed at grant only if their value is "readily ascertainable", which ordinarily requires that they be actively traded on a commercial market. Options whose value at grant is not "readily ascertainable" are ordinarily taxed at exercise, the income being measured by the spread between the option price and the value of the stock acquired. Detailed rules are provided for cases including factual variation—for example, when the option is not exercised but is sold or when the stock acquired pursuant to the option is subject to substantial restrictions. Thus, regulations provide treatment for all employee stock options not given specific treatment under Section 421. 67/

As for the treatment of the corporate employer, regulation 1.421-6(f) states that the employer corporation is considered to have paid compensation to the employee to the extent that he is required to include an amount in his gross income and hence the corporation receives a deduction under section 162 of the Internal Revenue Code.

Restricted Stock Options

A "restricted" stock option is one which was granted after February 26, 1945, and before 1964 and which meets certain conditions. In Exhibit 16 to the President's 1963 Tax Message to Congress, the legislative treatment of restricted stock options was explained as follows:

At present, under section 421 of the Code, if an option qualifies as a restricted stock option, the employee is not deemed to receive taxable income at the time of exercise. In the typical

case where the option price is at least 95 percent of the stock's value at the date of grant, any amount over the option price realized by the employee upon sale of the stock is taxed as a long-term capital gain, provided the sale takes place at least two years after the option is granted and six months after it is exercised. If the stock acquired with the restricted option is held until death, the gain over the option price is not taxed at all and the employee's estate or heirs receive a stepped-up basis for the stock.

If the option price of the stock is between 85 percent and 95 percent of its market value at the date of grant, when the stock is sold or left at death, part of any amount received over the option price is treated as ordinary income and part as long-term capital gain. Ordinary income tax rates apply to that part of the gain which represents the spread between the option price and the market price of the stock at date of grant, or the spread between the option price and the value of the stock at time of sale or death, if that is lower. The portion of the gain over the option price, in excess of the amount taxed as ordinary income, is accorded the same long-term capital gains treatment described above for 95 percent options.

The corporation receives no deduction at any time for issuing the option.

In order for the option to qualify for the special tax treatment as a restricted stock option, the following conditions must be met:

1. The recipient must be an employee when the option is granted, and must exercise it while an employee or within three months after his employment is terminated. (However, the three months requirement does not apply when the option is exercised after the death of the recipient.)
2. The option must be nontransferable, except at death.
3. The option must not extend for more than 10 years from the time it is granted. However, if the optionee owns more than 10 percent of the voting stock, the period for exercising the option must not exceed five years.
4. The option price must be at least 85 percent of the market price at the time of grant, or 110 percent in the case of an optionee owning more than 10 percent of the voting stock.

The price requirement can be met by a variable price formula based on the market price at time of exercise. Provision is also made for resetting the option price at not less than 85 percent of market value if the market price during the preceding 12 months averages less than 80 percent of the price at time of grant. 68/

The President recommended the elimination of the present preferential treatment for stock option benefits for the following reasons:

1. Stock options represent compensation for services. Tax-payers are generally required to pay ordinary income tax on their compensation. To the extent that the stock option provisions allow highly-paid executives to pay tax at capital gains rates or to escape all tax on part of their compensation, they are not consonant with accepted principles of tax fairness.

2. The preference conferred by present law on stock options is of particular significance in view of the very substantial amount of benefits offered by such options. How large these benefits have been for high-income executives is shown by a recent study covering 166 top executives in 31 of the 50 largest industrial corporations for the period 1950-1960. For these executives, option benefits resulting from the favorable spread between market price at date of exercise and the option price averaged \$83,000 per year—about 65 percent as much as their average salary of \$128,000. Thirty-eight percent of the 166 executives enjoyed option benefits which, after reduction for capital gains tax, exceeded their after-tax salaries and bonuses.

3. Enactment of the present treatment of employee stock options was based on the belief that such options provide a unique incentive to recruit, to hold, and to stimulate business executives to greater effort. While management has increased its stock ownership through options, the advantages claimed do not appear to be substantiated by experience.

a. Option benefits are haphazardously distributed. The rewards they confer on highly paid executives have been related not so much to their efforts in improving company profits as to changes in investor outlook and stock prices.

b. Sizable option grants to executives who are large stockholders and already have an important stake in company earnings cannot be justified on incentive grounds. One executive already owning 12 percent of company stock realized option benefits of almost \$4 million; another, with 51 percent control, the only employee in the firm to receive options, enjoyed option benefits amounting to \$2.5 million on exercise.

c. The use of stock options frequently tends to impede rather than to improve executive mobility. The available evidence suggests that options are used almost entirely to reward present management rather than to attract new executives. The conditions of their exercise are usually calculated to tie executives to their present jobs.

4. Extensive selling of option stock is inconsistent with the objective of stock options to create a proprietary interest in the business for executives. Treasury studies show that about two-thirds of the recipients dispose of all or part of their option stock within three years.

5. It is doubtful if stock options are the most efficient method of rewarding employees, except in the highest salary ranges. Because the cost of stock options is not deductible, a corporate employer, subject to the present 52 percent rate, could at the same cost to itself make a deductible salary payment of \$208 in lieu of each \$100 of compensation provided through a stock option. Under present rates, a married employee with a taxable income (after exemptions and deductions) below \$36,000 who does not sell his option stock but keeps it until death, would be better off with a cash payment of \$208. The break-even point is now over \$64,000 of taxable income for an executive who realizes a capital gain. With the lower individual and corporate income tax rates proposed under the tax reform program, the break-even point for the latter would be \$76,000.

6. Stockholders have become increasingly concerned over the dilution of their equity by the considerable amounts of stock reserved for option plans. The spread between option price and market price frequently involves a substantial cost which is not reflected on the corporation's books and is not fully disclosed in its financial report. In a significant proportion of cases in some years this cost has exceeded 10 percent of after-tax earnings. 69/

The President recommended 70/ that section 421 be repealed, and that, with respect to stock options granted after January 24th, 1963, the date of the message, the difference between the option price and the value of the stock at the date the option is exercised should be taxed at ordinary income rates, the income arising upon exercise of the option. If the ordinary income on exercise of the employee stock option involved a bunching of income, relief from tax hardship would be available under the proposed averaging provisions. The averaging formula proposed provides that "...averaging would apply to all individuals whose income in the fifth year exceeds their average income in the 4 preceding years by at least one-third. The portion of their income subject to averaging would be, with certain necessary constraints, income in excess of $133 \frac{1}{3}$ per cent

of the average income for the immediately preceding 4 years. This excess income would be taxed in an amount equal to five times the tax payable on the first one-fifth of it". 71/ Further, a special provision would be added to the Code so that the income tax attributable to the exercise of an employee stock option would be eligible for instalment payment privilege. Thus, the tax attributable to exercise of the option would be permitted to be paid over five years, the taxpayer paying one-fifth in the year of exercise and one-fifth in each of the four succeeding years. If the employee died before the final payment, the remaining instalments would be payable with his last return.

That the Congress found the President's criticisms of the tax treatment of "restricted" stock options persuasive is clear from the stock option provisions in the Revenue Act of 1964, which are

...designed to tighten the restrictions on the preferential tax treatment of stock options in order to eliminate many of the abuses that have often undermined the original intention of the law. The basic idea underlying the new provisions is that stock options are a privilege which should be accorded favorable tax treatment only when justified as an incentive technique. In this view, therefore, stock options may be desirable as a means of permitting key executives to acquire a proprietary interest in corporations, but should not be used merely as a means of providing additional compensation on which ordinary income taxes can be avoided. 72/

Qualified Stock Options 73/

An employee is not taxed when a qualified stock option is granted or exercised. Nor is the corporation allowed a business expense deduction at either of these times. And the option price paid by the employee for the stock is considered to be the amount received by the corporation for the stock.

The employee has to pay a tax only when he sells the stock obtained by exercise of the option. And since the option price may not be less than the market value of the stock at the date the option is granted, any gain on sale of the stock is taxed as capital gain provided that the stock is held for at least three years.

If stock acquired under a qualified stock option has been held less than three years when it is sold, the spread between the option price and the value of the stock at the time the option is exercised is treated as ordinary income at the time the stock is sold and is allowed as a deduction to the employer corporation. Any excess of the selling price over the value of the stock at exercise of the option is capital gain.

Where the stock is sold (in a transaction in which loss would be recognized) for less than the option price, there is no ordinary income and the difference between the option price and the amount realized is a capital loss.

For an option to qualify, the following conditions must be met:

1. The option price must not be less than the fair market value of the stock when the option is granted. This eliminates the former provision which allowed the option price to be as low as 85 per cent of the market price.

Some corporations, however—particularly small ones which do not have actively traded stock—cannot accurately gauge the market price of their stock. In order that stock options of such firms will not be invalid because of the inadvertent undervaluation of

the market price at the time the option is issued, a special provision has been included. Under this provision, if there has been an inadvertent underpricing, the difference between the option price and the fair market value of the stock at the time the option is exercised will be treated as ordinary income up to the amount of one-and-a-half times the difference between the option price and the fair market value at the time the option is granted.

2. The plan must be approved by stockholders within 12 months before or after adoption and must indicate the total shares issuable under options and the employees eligible to receive options.
3. The option must be granted within ten years after the date of stockholder approval or corporate adoption, whichever occurs earlier.
4. The option must be exercisable within five years after it is granted. This eliminates the former provision under which certain options could remain outstanding for ten years.
5. The option must not be exercisable while there is outstanding any qualified stock option granted to the employee at an earlier time and with a higher option price.
6. The option may not be transferable (other than by will or laws of inheritance) and may be exercisable only by the employee to whom it is granted.
7. Stock option tax treatment is denied to "substantial" shareholders of a corporation. In the case of a large corporation, a "substantial" shareholder is any person holding 5 per cent or more of the voting

stock. This provision will eliminate the abuse by which some large shareholders use stock options primarily to increase their control over a corporation.

Options Issued Under Employee
Stock Purchase Plans

Options which are issued after 1963 under an employee stock purchase plan, by which companies secure financial capital through the sale of stock at less than market price, will be governed by the same rules (with minor modifications) as apply to "restricted stock options", provided the plans are established on a non-discriminatory basis. That is to say, the option must be granted to all employees, except that part-time employees, employees with less than two years' service, and officers, supervisors, and highly compensated employees may be excluded from the plan. Another non-discriminatory requirement is that all employees granted options must have the same rights and privileges, except that the amount of stock which may be purchased by any employee may be a uniform percentage of compensation and the plan may limit the maximum number of shares to be purchased by any one employee.

SIZE AND DISTRIBUTION OF OPTION BENEFITS IN CANADA

There is little up-to-date, detailed information available as to the extent to which stock options have been used in Canada, the employees upon whom they have been conferred, the extent to which they have been exercised or disposed of, the amount of benefit obtained, or their effectiveness as an incentive. Some information has however been gathered. 74/

It would appear from a study made on behalf of the National Industrial Conference Board, Inc. of the provisions of stock option plans

of thirty Canadian companies that stock options are granted primarily to executives. According to that study, the stock option plans formed part of the compensation programmes for key employees who had a major and reasonably direct responsibility for the company's profits or who were considered to have exceptional capacity for growth in the company's service. 75/

APPRAISAL OF SECTION 85A

Benefits arising under stock option plans are essentially compensatory in nature, as the Honourable D. C. Abbott explicitly recognized in his 1953 Budget Speech, in which he introduced the legislation granting such benefits preferential tax treatment. Very substantial tax savings may be enjoyed by reason of section 85A, and sophisticated tax advisers write glowingly of the advantages of this form of compensation. 76/ Many people doubtless believe, for a variety of reasons, that despite the desirability of encouraging ownership by employees of stock in the company for which they work, there is no justification for a tax system which, on the one hand, imposes high rates of tax on earnings from work and then excuses compensation paid in the form of stock options from such rates, that stock option benefits should be taxed at the rates which apply to other forms of compensation, and that section 85A is a substantial loophole in the tax law and permits tax avoidance by a preferred few. 77/

Criticisms of the Provision

STOCK OPTIONS ARE DISCRIMINATORY

According to the study by Kinley, Stock Option Plans in Canada, stock option benefits are enjoyed by a very narrow segment of the

population—medium and top management—which is very likely among the highest paid. If corporate executives feel the pinch of high tax rates, so do other taxpayers, many of whom are not so favourably situated.

INEQUITY

It is inconsistent with equitable tax principles to excuse compensation paid in the form of stock options from the high rates of tax imposed on other compensatory payments. In view of the fact that the grant of an option is a riskless proposition for the employee, in that he need make no investment until the price of the stock has risen appreciably so as to assure a profit, it becomes even more difficult to justify preferential tax treatment for this form of benefit. Moreover, the employee has the best of all worlds, in that he is given an election whether to be taxed under section 85A or under the ordinary provisions of the Income Tax Act. In Mr. Abbott's language,

It is the same as any other lump sum payment. An employee would have the option of taking the benefit into his ordinary income and paying tax on it; and if he had no taxable income that year it might be to his advantage to take it in and pay the lower rate of tax. He has the option however of either including the benefit as a part of his income for the taxation year in which the benefit is realized or treating it as a lump sum payment in that year and paying tax accordingly at the effective rate of tax over the past three years less the 20 per cent credit. 78/

DEPARTURE FROM THE "ABILITY TO PAY" PRINCIPLE

The favourable tax treatment accorded to stock option benefits is a substantial deviation from the concept of "ability to pay", which has been a basic principle in the Canadian tax structure in the apportionment of the total tax burden.

LOSS OF REVENUE

Information is not available as to the extent to which stock option benefits have been enjoyed by Canadian executives and other employees; hence the revenue loss, if any, to the government cannot be accurately assessed. If stock option benefits were taxed at ordinary income rates, it may well be that stock options would virtually cease to be used as a form of compensation, and no increase in revenue would materialize. If other forms of remuneration, such as higher salaries and bonuses, were substituted, they would, of course, be taxed at full rates, but would also be claimed as a deduction by the corporation, so that a revenue loss might well result. Revenue effects, however, are only one facet of the problem. A more important consideration is the distribution of the total tax burden among all taxpayers.

STOCK WATERING

Stock option benefits may penalize the shareholders of a company, for the exercise of the option at bargain prices necessarily involves a dilution of the stock, and thus is a direct cost for each shareholder. Indeed, the shareholders might be better off if increased salaries were paid to executives in lieu of stock option benefits, for salaries would be deductible by the corporation.

In the light of these criticisms of section 85A, the policy of granting preferential tax treatment to stock option benefits becomes difficult to justify, unless there are compelling reasons which tip the balance in favour of its continued existence.

Reasons Advanced by the Minister of FinanceFAVOURABLE TAX TREATMENT OF OTHER BENEFITS

In his 1953 Budget Speech, Mr. Abbott pointed out that other forms of benefits from an office or employment receive favourable tax treatment, such as benefits obtained under group insurance plans and medical service plans. Therefore, he said, it would not be unreasonable to exclude by some device the "modest" benefits received under stock purchase plans. 79/ To this view it may be answered that while it may well be appropriate for our tax laws to encourage the widest possible coverage of security arrangements in order to advance a desirable social policy, stock option benefits are granted for a variety of reasons, 80/ and do not fall within that cluster of arrangements that are designed primarily to provide security for an employee, to protect him and his family against the financial loss of sickness, accident, disability and death.

Moreover, the Minister was pulling himself up by his bootstraps by reasoning that because certain benefits are favourably treated, stock option benefits also should be favourably treated. Such reasoning can only lead to a proliferation of the exemptions and privileges that have resulted in a substantial erosion of the tax base. The contention might now be advanced that the benefit arising to an employee from the personal use of his employer's automobile ought to receive favourable tax treatment because benefits from group insurance, medical service and stock option plans are now given special treatment.

MODEST BENEFITS SHOULD NOT BE TAXED

Mr. Abbott stated that so long as the benefit enjoyed by the employees

was "not excessive I do not think we should attempt to tax that modest benefit, because it is not charged by the corporation as an expense". 81/ However, the quantum of the benefit is only one of the factors that determine the amount of tax payable, the other important element being the applicable rate, which is dependent not on the amount of the benefit but on the recipient's income for the preceding three years. Thus, it would be quite possible for a taxpayer who realized a large stock option benefit to pay little or no tax on it if he had only a modest income during the preceding three years.

Little information is available as to the magnitude of the gains that have been realized by Canadian employees under stock option plans. They may or may not be modest benefits. Mr. Abbott recognized the possibility of abuse when he explained that one of the purposes of section 85A was to take care of a loophole: "...it was felt that it was necessary to prevent an abuse of these stock option devices through allowing employees, perhaps executives of a corporation, to get very large benefits which would not be taxable". 82/ [Emphasis added.] And yet there are no safeguards or restrictions in section 85A which limit the amount of the benefit which an employee may enjoy and have taxed at favourable rates. 83/

STOCK OPTION BENEFITS ARE NOT CLAIMED
BY CORPORATIONS AS A DEDUCTION

One of the reasons given by the Minister of Finance for the 20 per cent reduction in the tax rate applicable to stock option benefits was that no deduction was taken by the corporation. However, according to the House of Lords, there is good reason why a corporation is not entitled to deduct the cost of stock option benefits, namely, the fact that the gain to the employee

is not derived at the expense of the employer, which has simply forgone the cash value of the premiums. 84/

Stock Options are Incentives

In the United States, the use of stock options has been justified as providing "...an incentive to attract, encourage and retain capable employees, usually at the executive or management level.... Stock options have long been used as an effective incentive for present and prospective executive talent by giving them a proprietary share in the business. Satisfying as they do an individual's normal desire to be an owner and share in the fruits of his own labor, stock options permit corporate managers to work with some of the same interests that motivate partners and self proprietors". 85/

While incentives doubtless have a legitimate place in Canadian industry, in his 1953 Budget Speech Mr. Abbott did not even suggest that one of the reasons for the enactment of section 85A was to stimulate the use of stock option plans to encourage executive talent to become proprietors in the business. Nor is section 85A tailored to meet this objective, for unlike section 422 of the Internal Revenue Code, the Canadian provision contains no requirement that stock acquired by an employee under a stock option be held for any stipulated period of time. Indeed, the section contemplates the disposition as well as the exercise of rights conferred on the employee so that he may never acquire a proprietary interest in the business. Moreover, United States experience does not appear to substantiate the advantages claimed for stock options as incentive devices, 86/ and Dean Griswold has pointed out:

...the incentive involved in stock options tends to be very uncertain and haphazard. If we are really seeking to provide incentive, it would seem that there are at least two things that we might do: (1) We might learn a lot more about what really are the incentives which lead people to engage in productive and useful work, and (2) we might find a tax device which would provide financial incentive in a far less discriminatory and haphazard form. 87/

POSSIBLE ALTERNATIVES

If Parliament were satisfied that the provisions of section 85A were overly generous, a number of possible alternatives present themselves:

1. Parliament might repeal section 85A, and tax the value of all stock options at the time of receipt under section 5(1)(a) as income from an office or employment. This solution is unsatisfactory on at least two grounds: (a) the major reason which led to the enactment of section 85A—the possibility of substantial tax avoidance—would again arise; 88/ and (b) an injustice may be worked in circumstances where an employee is taxed in respect of the value of his option at the time he receives it, and the stock then drops in value before he is in a position to purchase the shares.
2. Parliament might tax the difference between the option price and the market value at the date of exercise of the option at ordinary rates, in order to frustrate tax avoidance, and refuse any deduction to the corporation. According to the reasoning of the House of Lords in the Lowry case, this treatment does no injustice to the company, which incurs no expense in selling its shares at less than market value. It would probably increase revenue yields, assuming that stock options continued to be used. While the increase in the price of shares might well be attributable to factors other than the

employment, as the House of Lords pointed out in Abbott v. Philbin, nevertheless the gain does come to the employee with little risk, since he need not invest until the gain is assured by reason of an increase in the price of the stock. It is perhaps not unfair that such gains should be taxed at ordinary income rates. Moreover, if the income tax base could be broadened by, for example, the repeal of provisions granting unwarranted exemptions, deductions and privileged tax treatment, and the revenue yield were substantially enhanced as a result, the happiest solution of all might become a reality—an overall reduction in the tax rates.

3. Parliament might tax the difference between the option price and the market value at the date of exercise of the option at ordinary rates, and allow a deduction to the company. Although the benefit conferred on the employees has been held not to be an "expenditure" of the company and is therefore not deductible (Lowry v. Consolidated African Selection Trust, Ltd., supra), the economic loss to the company in compensating its employees in this way seems clear, so that a deduction can be justified. This solution might also diminish government revenues but would, however, be advantageous to the other stockholders of the company by easing its tax burden.
4. Parliament might treat the difference between the option price and the market value at the date of exercise as a lump sum payment and tax it under an averaging provision, perhaps similar to that applied to payments out of pension funds and retiring allowances. This is the solution recommended in the President's 1963 Tax Message (discussed supra). One difficulty here is that many option plans provide

for annual purchases, and the gains assume a recurring nature and do not readily lend themselves to lump sum treatment. 89/

5. Parliament might tax employees in respect of the difference between the purchase price of the shares acquired under a stock option and the ultimate sale price of the shares. This proposal involves the taxation of a capital gain, namely, the increment in the value of the stock after the employee has purchased it. Although this solution would obviate the thorny problem of valuing shares in private companies, or shares subject to restrictions on disposition, it is quite out of keeping with established Canadian taxing principles and would have to be considered in the larger context of a capital gains tax. Provisions would have to be made, of course, for the deduction of losses.

Table 1

SCHEDULE A

TABLE 1

EMPLOYEE STOCK OPTIONS - FIGURES FROM REPLIES TO QUESTIONNAIRE GIVEN BY 83 COMPANIES

Type of Company	Total of Shares Acquired under Options in Past 7 Years	Total of Shares at Present Subject to Stock Options	Dollar Value of Shares at Present Subject to Stock Options	Are Stock Options Important to Key Employees?	Obtain or Retain		
				Yes	No	No Answer	No. of Companies
\$							
Assets over \$90 million							
Mining, etc.	322,784	440,620	13,799,046	3	1	1	5
Pulp and Paper	3,466	93,534	2,387,496	2	2	-	4
Primary Metal Manufacturing	249,144	30,678	1,891,720	3	1	-	4
Petroleum, etc.	506,423	557,375	13,506,773	7	-	-	7
Other Manufacturing	432,873	642,736	12,165,555	10	1	-	11
Transport, Communication, Utilities	325,991	202,584	4,648,026	4	-	-	5
Trade	-	-	-	-	-	-	1
Sub-total	1,840,681	1,967,527	48,398,616	29	6	1	37
Assets \$25 million to \$90 million							
Mining, etc.	87,550	31,400	158,850	1	1	-	2
Pulp and Paper	100	48,400	943,800	5	-	-	5
Primary Metal Manufacturing	-	-	-	-	1	-	1
Petroleum, etc.	-	28,000	308,000	3	-	-	3
Other Manufacturing	44,720	147,780	3,215,400	9	3	-	12
Transport, Communication, Utilities	80,300	95,100	1,506,375	3	-	-	3
Trade	44,375	65,750	1,446,500	1	-	-	1
Sub-total	257,045	416,430	7,578,925	22	5	-	27
Assets under \$25 million							
Mining, etc.	-	-	-	-	-	-	0
Pulp and Paper	-	-	-	-	-	-	0
Primary Metal Manufacturing	9,445	10,175	24,650	3	1	-	4
Petroleum, etc.	45,025	80,475	1,126,650	1	-	-	1
Other Manufacturing	26,225	219,000	222,000	3	8	-	11
Transport, Communication, Utilities	-	25,000	112,500	1	-	-	1
Trade	-	-	-	1	2	-	3
Sub-total	80,695	334,650	1,485,800	9	11	-	20
TOTAL	2,178,421	2,718,607	57,463,341	60	22	1	57

SCHEDULE A

TABLE 2

EMPLOYEE STOCK OPTIONS - FIGURES FROM REPLIES TO QUESTIONNAIRE GIVEN BY 83 COMPANIES

Type of Company	Total of Shares Acquired under Options in Past 7 Years	Total of Shares at Present Subject to Stock Options	Dollar Value of Shares at Present Subject to Stock Options \$	Are Stock Options Important to Obtain or Retain Key Employees?			
				Yes	No	No Answer	No. of Companies
Mining, etc.	410,334	472,020	13,957,896	4	2	1	7
Pulp and Paper	3,566	141,934	3,331,296	7	2		9
Primary Metal Manufacturing	258,589	40,853	1,916,370	6	3		9
Petroleum, etc.	551,448	665,850	14,941,423	11	0		11
Other Manufacturing	503,818	1,009,516	15,602,955	22	12		34
Transport, Communication, Utilities	406,291	322,684	6,266,901	8	0		8
Trade	44,375	65,750	1,446,500	2	3		5
TOTAL	2,178,421	2,718,607	57,463,341	60	22	1	83

SCHEDULE B COMPANY "A" (ASSETS, \$188,000,000) - 1952 STOCK OPTION PLAN BENEFITS

Employee	1954			1955			1956			1957			1958			1959			1960			1961			1962			Years Employed	Total Salary	Total Benefit	Per Cent	
	Salary	Benefit	Per Cent	Salary	Benefit	Per Cent	Salary	Benefit	Per Cent	Salary	Benefit	Per Cent	Salary	Benefit	Per Cent	Salary	Benefit	Per Cent	Salary	Benefit	Per Cent	Salary	Benefit	Per Cent								
1	20,500			19,553			21,000			23,317			21,500	228	1.0	23,943	2,355	9.8	21,000	18,372	87.5	22,644	10,476	46.3	23,400	15,466	66.1	1954-62	199,357	46,877	23.5	
2	13,700			14,987			18,992			23,256			22,949			23,943	1,907	8.0	21,300			23,024			24,400			1954-62	156,551	1,907	1.2	
3	19,000			23,372			24,794			32,104			42,013	12,357	29.4	42,906	48,500	113.0	36,500	19,708	54.0	39,621	6,085	15.4	44,500	10,494	23.6	1954-62	304,816	84,787	27.8	
4	23,000			27,940			30,920	31,033	100.4	29,599			29,920	5,688	19.0	30,420			27,500			29,500			30,000			1954-62	258,799	31,033	12.0	
5	24,500			30,067	15,470	51.5	39,920	8,834	22.1	59,954	8,867	14.8	97,815			106,712	17,680	16.6	100,000			110,000	10,444	9.5	115,785	24,955	21.6	1954-62	684,753	98,607	14.4	
6	16,576			19,620			22,441			22,795			22,441			-	9,100	-	-				-			-		1954-58	104,173	14,788	14.2	
7	73,000			62,000			65,800			60,770			45,000			-	467,552	-	-				-			-		1954-58	386,570	467,552	120.9	
8	12,551			18,624			22,655			23,481			31,294			32,226			28,000	33,175	118.5	31,000			33,249			1954-62	233,080	33,175	14.2	
9	26,500			32,801			39,220			42,939			47,377			47,369			43,633	137,161	314.4	47,500			50,500			1954-62	377,839	137,161	36.3	
10	21,049			23,246			25,000			21,779			21,444			9,380	15,390	164.1	-			-			-			1954-59	121,998	15,390	12.6	
11	21,500			21,520			27,993	28,401	101.5	30,335	8,106	26.7	31,506	11,002	34.9	34,920	16,533	47.3	31,000	13,696	44.2	36,410	13,983	38.4	35,500	12,867	36.2	1954-62	270,684	104,588	38.6	
12	14,109			16,326			19,474			20,747	3,175	15.3	18,950			-			-			-			-			1954-58	89,606	3,175	3.5	
13	8,008			10,208			13,430			15,477			19,086			21,449	976	4.6	14,992			21,900			23,810			1954-62	147,180	976	0.7	
14	25,750	5.913	22.9	24,099			31,429	22,015	70.1	32,599			32,864	12,081	36.8	38,414			34,700	45,432	130.9	37,000	15,400	41.6	40,677	13,094	32.2	1954-62	297,532	113,945	38.3	
15	21,000			23,396	6,650	28.4	26,632	9,312	35.0	29,751	4,683	15.7	32,413	10,662	32.9	34,425	14,647	42.5	31,500	12,067	38.3	34,909	10,564	30.3	36,500	12,562	34.4	1954-62	270,526	81,147	30.0	
16	9,311			10,092			11,140			11,869			17,447			19,381			18,000	1,706	9.5	19,863			21,500			1954-62	138,603	1,706	1.2	
17	15,561			16,677			18,453			20,382			21,754			23,144			21,088	1,738	8.2	-			-			1954-60	137,059	1,738	1.3	
18	14,162			25,086			29,433			29,335			23,433			-	24,406	-	-				-			-		1954-58	121,449	24,406	20.1	
19	25,422			23,752			27,836			27,279			29,175			29,934			26,500	10,897	41.1	27,500			-	3,472	-	1954-61	217,398	14,369	6.6	
20	13,233			20,407			22,953			23,725			23,448			23,448			19,500	2,326	11.9	20,852			22,700			1954-62	190,266	2,326	1.2	
21	12,224			16,224			19,875			18,740			19,418			18,918	1,879	9.9	16,200	910	5.6	9,689	706	7.3	-			1954-61	131,198	3,495	2.7	
22	24,500			23,788	16,178	68.0	22,177	9,928	44.8	21,768	10,636	48.8	21,943	11,987	54.6	24,193	16,037	66.3	22,700			24,000	12,628	52.6	24,100	20,258	84.1	1954-62	209,189	97,634	46.7	
23	26,500	1,047	3.9	31,666	1,463	4.6	38,281			40,907			41,358			43,907	95,875	218.4	37,800			39,500	13,294	33.7	44,553	20,469	45.9	1954-62	344,472	132,148	38.4	
24	17,761			15,810			15,310			-	12,711	-	-			-			-			-			-			1954-56	48,881	12,711	26.0	
Annual Average			13.4				62.3			24.3 a/			29.8			63.7 a/			72.0			30.6			43.0 a/			Overall Average, 41.9				22.2

SCHEDULE C COMPANY "B" (ASSETS \$633,000,000) ROCK OPTION PLAN BENEFITS - PLAN ADOPTED IN 1956

[illegible]

SCHEDULE D

COMPANY "C" (ASSETS \$125,000,000)
 PLAN ADOPTED IN 1960

<u>Number of options Exercised</u>	<u>Average Salary</u>	<u>Average Taxable Benefits (Spread between Value of Shares when Acquired and Option Price).</u>
	<u>Year 1961</u>	
3	\$64,000	\$5,810
2	31,000	280
2	26,500	2,750
10	21,300	1,950
9	16,300	1,700
11	13,000	990
	<u>Year 1962</u>	
3	\$64,000	\$7,710
4	31,750	5,410
2	26,500	3,900
8	21,500	2,630
14	17,000	2,550
14	12,300	1,170

SCHEDULE E

COMPANY "D"

In 1955 options to purchase stock at the market price at that time were granted to 23 key members of the staff. They were taken up over the 5-year period before expiration in 1960, and the 21,400 shares so taken up provided benefits based on the prices of the stock on the dates of exercising the options, amounting to \$49,843.75. This is an average of 11.21 per cent of the salaries of the recipients as of the time of granting the options in 1955, but it is important to note that these benefits were granted not on any basis related to salaries, but as a result of evaluation by the management of the merits of each recipient.

In the same year, 1955, and each year since, another form of additional remuneration of key men was adopted, namely, the sale of company shares at prices below the market price. These are shares purchased on the market by a subsidiary company for this purpose. The following are the number of persons involved, the number of shares allotted, and the value of the benefit at time of award:

	<u>Number of Recipients</u>	<u>Number of Shares Allotted</u>	<u>Value of Benefit</u>
1955	44	11,750	\$ 73,437
1956	46	14,000	103,250
1957	45	12,150	89,606
1958	49	13,500	96,187
1959	50	14,100	148,050
1960	50	22,200	183,150
1961	52	23,450	240,362
1962	47	14,705	257,337

In 1955 the average percentage of benefit to salary was 11.72 per cent. This percentage progressively increased until in 1962 it was 28.56 per cent. Again there is no direct relationship between the award and the salary, the basis being individual merit as evaluated by the management.

There is also in effect another provision for the acquisition of stock by employees. It provides for loans to employees who are earning salaries of \$5,000 and over and who wish to purchase common stock of the company in the ordinary way through a broker at the market price. Loans of up to 80 per cent of the cost of the stock purchased are granted, and are repayable with interest by way of salary deductions over a period of one year. The number of shares purchased is limited to one share per \$100 of annual salary. Thus, no benefit is given, other than making available this loan accommodation.

SCHEDULE F

COMPANY "E"

Employees' Stock Purchase Plan, 1953. In July 1953, an employees' stock purchase plan was initiated whereby approximately 75 senior employees were given the opportunity to subscribe for unissued common shares. Individual subscriptions were limited in proportion to salaries received (the same proportion, 30 per cent, for all participants) and the price was fixed at \$25 per share, or approximately 85 per cent of the market price at the time the plan was adopted. A total of 15,978 shares was taken up under the plan in 1953.

Employees' Stock Purchase Plan, 1959. In June 1959, approximately 400 senior employees were given the opportunity to subscribe for unissued common shares at \$63 per share, or approximately 80 per cent of the market price on the day the plan was adopted. A total of 19,513 shares was taken up by 402 employees.

The president suggested that if the stock purchase plan were used again the coverage would probably be extended to about 1,000 employees.

SCHEDULE G

COMPANY "F"

This company has recently set aside 100,000 shares to be sold under option to senior employees. Options for 40,000 shares have been issued. They are exercisable over a period of ten years and provide for the purchase of shares at the market price prevailing on the day the option was granted. The purpose of the option plan is to provide additional rewards for senior employees at a slightly lower tax rate and to provide them with an incentive for increased efforts on behalf of the company.

REFERENCES

- 1/ Ede v. Wilson, 26 Tax Cas. (1945), 381; No. 126 v. M.N.R., 9 Tax A.B.C. (1953-54), 241; 53 DTC 419; Snell v. M.N.R., 17 Tax A.B.C. (1957), 186; 57 DTC 299; Kinley, Stock Option Plans in Canada, National Industrial Conference Board Inc., 1959, p. 5.
- 2/ M.N.R. v. Tomkins, [1963] C.T.C. 258; 63 DTC 1164.
- 3/ Ede v. Wilson, supra, reference 1/.
- 4/ Bridges v. Bearsley, 37 Tax Cas. (1957), 289.
- 5/ G. McGregor, "Around the Courts", 8 Canadian Tax Journal (1960), 391.
- 6/ Weight v. Salmon, 19 Tax Cas. (1935), 174; Abbott v. Philbin, 39 Tax Cas. (1960), 82.
- 7/ F. E. LaBrie, Introduction to Income Tax Law—Canada, Toronto: CCH Canadian Limited, 1955, p. 45.
- 8/ 17 Tax A.B.C. (1957), 186; 57 DTC 299.
- 9/ Bridges v. Bearsley, 37 Tax Cas. (1957), 289 (shares received by officer as act of bounty and not as compensation for services); Cowan v. Seymour, 7 Tax Cas. (1919), 372; Seymour v. Reed, 11 Tax Cas. (1927), 625; Wright v. Boyce, 38 Tax Cas. (1958), 160.
- 10/ See the leading case of Goldman v. M.N.R., [1953] 1 S.C.R. 211; [1953] C.T.C. 95; 53 DTC 1096.
- 11/ 9 Tax Cas. (1925), 297 at pp. 300-01.
- 12/ See, for example, Fowler v. M.N.R., 32 Tax A.B.C. (1963), 353; 63 DTC 600.
- 13/ See the discussion of the difficulties of valuation of shares carrying restrictions on disposition, at pp. 148-150, infra.
- 14/ 19 Tax Cas. (1935), 174.
- 15/ Ibid., p. 193.
- 16/ 9 Tax A.B.C. (1953-54), 241; 53 DTC 419.
- 17/ 17 Tax A.B.C. (1957), 186; 57 DTC 299.
- 18/ 12 Tax A.B.C. (1954-55), 335; 55 DTC 192.
- 19/ Ibid., Tax A.B.C. at p. 338; DTC at p. 194.

- 20/ See for example, Leigh v. C.I.R. [1928] 1 K.B. 73 at p. 77: "...for income tax purposes 'receivability' without receipt is nothing".
- 21/ Gardner Mountain & D'Ambrumenil v. C.I.R., 29 Tax Cas. (1947), 69 at p. 94.
- 22/ Whitworth Park Coal Co. Ltd. v. C.I.R. [1961] A.C. 31 at p. 77, per Lord Keith of Avonholm.
- 23/ See Dracup v. Radcliffe, 27 Tax Cas. (1946), 188 and Heasman v. Jordan, 35 Tax Cas. (1954), 518.
- 24/ 39 Tax Cas. (1960), 82.
- 25/ [1892] A.C. 150.
- 26/ 39 Tax Cas. (1960), 82 at pp. 125-26, per Lord Radcliffe.
- 27/ Ibid., p. 126.
- 28/ Ibid., p. 128.
- 29/ Ibid., p. 124.
- 30/ 39 Tax Cas. (1959), 132.
- 31/ Ibid., p. 141.
- 32/ This was the case in Bently v. Evans, 39 Tax Cas. (1959), 132; and Ede v. Wilson, 26 Tax Cas. (1945), 381.
- 33/ 37 Tax Cas. (1957), 289.
- 34/ [1963] C.T.C. 258; 63 DTC 1164.
- 35/ 39 Tax Cas. (1960), 82 at p. 125, per Lord Radcliffe.
- 36/ See No. 179 v. M.N.R., 11 Tax A.B.C. (1954), 76 at p. 78; 54 DTC 336, at p. 337, where the Tax Appeal Board discussed the factors to be taken into account in the valuation of shares in a private company.
- 37/ 26 Tax Cas. (1945), 381.
- 38/ Ibid., p. 389.
- 39/ 39 Tax Cas. (1959), 82 at p. 88.
- 40/ A. R. Ilersic, "The Budget 1961: Occasion for Reform", [1961] British Tax Review 10 at p. 21.
- 41/ 9 Tax A.B.C. (1953-54), 241; 53 DTC 419.
- 42/ 12 Tax A.B.C. (1954-55), 335; 55 DTC 192.

- 43/ 39 Tax Cas. (1960), 82 at p. 120.
- 44/ 8 Tax A.B.C. (1953), 287; 53 DTC 204.
- 45/ McDonald, Canadian Income Tax, Section 25, paragraph 11(d).
- 46/ [1953] 1 S.C.R. 211 at p. 214; [1953] C.T.C. 95 at p. 103; 53 DTC 1096 at p. 1100.
- 47/ Income Tax Case Law, London: Stevens & Sons Limited, 1947, p. 27.
- 48/ 23 Tax Cas. (1940), 259.
- 49/ Ibid., p. 292.
- 50/ [1902] A.C. 474 at p. 480, per Lord Davey.
- 51/ House of Commons Debates, 1952-53, vol. 4, p. 3721.
- 52/ Fowler v. M.N.R., 32 Tax A.B.C. (1963), 353 at p. 356; 63 DTC 600 at p. 602.
- 53/ Canadian Tax Reporter, Toronto: CCH Canadian Limited, vol. 1-A, para. 15-191.
- 54/ [1963] C.T.C. 258; 63 DTC 1164.
- 55/ Ibid., C.T.C. at p. 264; DTC at p. 1168.
- 56/ 32 Tax A.B.C. (1963), 353; 63 DTC 600.
- 57/ I Canadian Tax Journal, Part 2 (1953), 109 at p. 111.
- 58/ Ibid., pp. 110-111.
- 59/ See supra, p. 170.
- 60/ I Canadian Tax Journal, Part 2 (1953), 109 at p. 110.
- 61/ House of Commons Debates, 1952-53, vol. 4, p. 3725.
- 62/ Ibid., p. 3720.
- 63/ Ibid., p. 3725.
- 64/ 351 U. S. (1956), 243.
- 65/ McNamara v. Commissioner, 210 F. 2d 505 (7th Cir., 1954); see also Commissioner v Smith, 324 U. S. (1945), 177 at pp. 181-82.
- 66/ Kuchman v. Commissioner, 18 T.C. (1952), 154.
- 67/ President's 1963 Tax Message to Congress, p. 460.

- 68/ Ibid., pp. 458-9.
- 69/ Ibid., pp. 455-6.
- 70/ Ibid., pp. 454-5.
- 71/ Ibid., p. 41.
- 72/ Treasury Department, Summaries of Provisions in the Revenue Act of 1964, Washington, D. C., March 1964, TP - 26. The new rules are discussed immediately below.
- 73/ The material contained in the following discussion of "qualified stock options" is taken primarily from Federal Tax Guide, Commerce Clearing House, Inc., vol. 1, 1964, para. 2829 B and D, and also from the Treasury Department's Summaries of Provisions in the Revenue Act of 1964.
- 74/ See Schedule A, infra, which sets out the results of this Commission's corporate questionnaire as regards stock options. See also Schedules B to G, infra, which set out information gathered by a member of the Royal Commission staff regarding the stock option plans of six Canadian companies in various fields of business.
- 75/ Kinley, Stock Option Plans in Canada, National Industrial Conference Board, Inc., 1959, p. 10.
- 76/ See Lancelot J. Smith, "Tax Position of Fringe Benefits", Corporate Management Conferences, Canadian Tax Foundation, 1959, 59 at p. 71: "An employee's stock option plan is probably the most attractive form of providing incentive benefits from the income tax point of view". See also Philip Vineberg, "The Tax Position of Fringe Benefits", ibid., 77 at p. 88: "One of the most appealing forms of fringe benefits is an arrangement whereby the employee subscribes to shares in the Company either by a direct undertaking to which he is committed or by some stock option arrangement which gives him the opportunity of acquiring the stock only in the event of it becoming advantageous".
- 77/ See the submission of The Canadian Labour Congress to the Royal Commission on Taxation where it is suggested that "It would also be worth while, in our opinion, to determine to what extent stock options contribute to income tax evasion". Preliminary brief, at pp. 4-5. At the hearing, Mr. Bell, spokesman for the Canadian Labour Congress, stated in response to a question by the Chairman "... it seems to me that income of this kind should be subject to the normal income tax rates and not have any special allowance made for it, as is the case now". Transcript of Hearings, vol. 3, p. 270.
- 78/ House of Commons Debates, 1952-53, vol. 4, p. 3725.
- 79/ Ibid., p. 3720.
- 80/ See supra, p. 132.

- 81/ Ibid., p. 3725.
- 82/ Ibid., p. 3721.
- 83/ An executive of a large Canadian company realized a stock option benefit of \$467,552 in 1959. See Schedule B.
- 84/ Lowry v. Consolidated African Selection Trust, Ltd., 23 Tax Cas. (1940), 259.
- 85/ Joseph L. Seligman, Jr., "Pension and Other Employee Benefit Plans", 2 Tax Revision Compendium, 1959, 1353 at p. 1362.
- 86/ See the President's 1963 Tax Message to Congress, quoted supra.
- 87/ E. N. Griswold, "The Mysterious Stock Option", 2 Tax Revision Compendium, 1959, 1327 at pp. 1331-32.
- 88/ See the discussion, supra, of Abbott v. Philbin, 39 Tax Cas. (1960), 82.
- 89/ See Kinley, Stock Option Plans in Canada, National Industries Conference Board, Inc., 1959, p. 15: "A majority of the plans permit purchase from time to time of any or all of the stock allotted, so long as the initial waiting period, if any, has been observed, but others limit this freedom. Twelve plans specify a maximum annual acquisition, or employ some similar device to spread the rate of acquisition".

CHAPTER 5

DEFERRED COMPENSATION ARRANGEMENTS

INTRODUCTION

The expression "deferred compensation" is not a term of art, and is not defined or even mentioned in the Income Tax Act. Generally speaking, in the context of income taxation, it expresses the notion or concept of a postponement of payment to an officer or employee of remuneration for services performed currently, and so construed, is broad enough to include retiring allowances and death benefits, which are paid in recognition of service of an employee, pension payments and deferred profit sharing payments, although the expression is perhaps more frequently used to describe contractual arrangements designed to minimize the income tax liability of highly paid executives.

The significance of "deferred compensation" stems from the provisions of section 5(1)(a) of the Income Tax Act which states that income from an office or employment is taxable in the year in which it is "received or enjoyed by the taxpayer" even though he may have earned it in an earlier year. Hence, postponement of receipt or enjoyment of remuneration results in deferment of tax. This result has been exploited through statutory and non-statutory means to accomplish different objectives ranging from tax minimization by executives to the loftier purpose of encouraging employees to save a portion of current earnings to provide security for their retirement years under the statutory provisions for registered pension plans and deferred profit sharing plans. The present

inquiry is limited to non-statutory, contractual deferred compensation arrangements, the treatment of other forms of deferred compensation having been dealt with elsewhere. 1/

NATURE AND TAX CONSEQUENCES OF
DEFERRED COMPENSATION CONTRACTS

A corporate executive receiving a salary of \$70,000 a year is subject to a marginal tax rate of 60 per cent, so that a salary increase of, say, \$15,000 would net him a relatively modest after-tax increment. He may well prefer to defer receipt of the added compensation until after his retirement, when, presumably, his marginal tax rate will be lower. He and his employer may attain this objective by entering into a contract which provides that the company will pay him a stated amount for life, commencing at age 65, the benefit payable under the contract being approximately equivalent in value to the salary increase which he would otherwise have received. From the standpoint of the employer the arrangement is satisfactory; he is properly entitled to deduct the retirement payments as and when made since they are not in the nature of capital outlays and may fairly be regarded as having been paid "for the purpose of gaining or producing income" from a business within the meaning of section 12(1)(a), since his obligation to make the payments affects the amount of salary which the executive accepts and will also induce the employee to remain in his employment. In this connection it is worth noting that in Smith v. The Incorporated Council of Law Reporting for England and Wales, 2/ a gratuity of £1,500 paid to a retired law reporter was considered by the General Commissioners to be "a business expense" and therefore an admissible deduction. Scrutton, J. affirmed their decision on the ground that "...there is evidence upon which the Commissioners,

judging facts, may find that those payments were made in the way of their trade, because they at any rate may affect the amount of ordinary salary which they pay to their Reporters". 3/ The arrangement is also satisfactory from the employee's standpoint, since he is taxed only as and when he receives the retirement payments after the age of 65.

It may be argued, however, that this acquisition by the employee of an unconditional commitment to receive payments in the future constitutes the receipt or enjoyment of a benefit in the year in which the contract is executed, and that the discounted value of the future payments should be included in the employee's income for that year. If the argument were accepted by a court, it would result in double taxation of the payments under the contract—first, in the year in which the contract was executed and again in the years in which the payments were made. It is unlikely that the argument would prevail, in view of the narrow construction which the words "received or enjoyed" have received at the hands of the courts. For example, in Pazuk v. M.N.R. 4/ it was held that payments made by an employer under a group annuity policy in respect of an employee's services were not taxable to the employee in the year in which the payments were made on the ground that he received nothing and enjoyed no benefits in those years from his employer's contributions. And in M.N.R. v. Rousseau 5/ it was held by the Exchequer Court that salary credited to an employee's account in the books of his employer, which amount the taxpayer could draw at his discretion, had not been "received" by the taxpayer and hence was not taxable in the year in which it was credited. In any event, this contention could be thwarted by the inclusion of a clause to the effect that the taxpayer would be entitled to the payments only if he remained with the company until retirement. Furthermore, if the measure of the

contractual payments was not a fixed amount but rather a variable amount, say, a percentage of the company's profits, the value of the future payments would be impossible to determine.

There is another point of time at which the value of the future payments might be sought to be taxed by the Minister, namely, when the employee reaches retirement age. There is virtually a complete dearth of authority on the taxability of an unconditional commitment to make future payments, apart from the bald statement, unsupported by judicial authority, made by Professor Wheatcroft: "Just as sums paid by an employer to provide his employee with future retirement benefits may give rise to a tax liability on the employee, so a similar liability may arise if the employer agrees in advance to provide them". 6/ Although the possibility of forfeiture is absent, the requirement of "receipt" again might well prove to be the rock upon which this contention would founder. Moreover, the parties could insert conditions in the contract requiring that the executive remain available for consulting or other part-time services following retirement, and that he refrain from engaging in, or associating himself with, a competitive enterprise, the object of these conditions being to create the possibility that the executive's retirement rights, now apparently fixed, may nevertheless be forfeited at some future date.

The nature of the conditions inserted in the contract might well be determinative of the tax treatment of the payments as and when made during the retirement years. For example, if a condition required the executive to be available for consultation, the payments would be remuneration, and as such would be deductible by the employer as an ordinary business expense and also taxable to the employee. On the other hand, if the

condition was that the retirement payments would be made only so long as the executive did not engage in, or associate himself with, a competitive enterprise, it is at least doubtful that such payments would fall within section 12(1)(a) as having been made for the purpose of "gaining or producing income" from the business. The payments would be taxable in the hands of the retired executive under section 25.

The major disadvantage of these deferred compensation contracts is, of course, the risk of non-payment by the employer, on whose solvency the employee must depend.

In summary, then, a carefully drafted deferred compensation contract would seem to be an effective instrument for minimizing tax liability.

USE OF DEFERRED COMPENSATION CONTRACTS IN CANADA

Very little information is available on the extent to which deferred compensation contracts are used in Canada. According to one commentator,

Naturally, the details are kept confidential and it is very difficult to estimate the volume in force. In the U.S. it is claimed that 80 per cent of substantial companies have entered into such arrangements. In Canada, we have found deferred compensation to be very popular, anything from 1 to 50 employees being included. So far no difficulty has been experienced with the tax authorities. Recognizing that there is a calculated risk involved, these plans form an attractive way of rewarding the executives while reducing the impact of taxation. 7/

APPRAISAL

In not a single case has the Department of National Revenue contended before the courts that a deferred compensation contract gave rise to income at any time prior to the receipt of the payments for which it made provision,

perhaps because the rights of the executives to future payments have been made sufficiently contingent through skilful drafting as to make the prospect of success remote. If these tax avoidance devices are regarded as constituting an abuse of the tax system, the statute could, of course, be amended to provide, in effect, that the acquisition by an employee of a right—even a contingent right—to future payments is taxable in the year in which the right is acquired. Even in these circumstances, a difficult valuation problem would remain, especially if the measure of the future compensation were flexible and depended, say, on the employer's future profits. A precedent for taxing contingent rights appears in section 79(3) of the Income Tax Act which provides that "There shall be included in computing the income for a taxation year of an employee who is a beneficiary under an employees profit sharing plan each amount that is allocated to him contingently or absolutely by the trustee under the plan at any time in the year...." Similarly, section 85A, which deals with employee stock options, provides in subsection (4) that "Where a share is held by a trustee in trust or otherwise, either absolutely, conditionally or contingently, for an employee, the employee shall be deemed, for the purposes of this section, to have acquired the share at the time the trustee commenced so to hold it".

REFERENCES

- 1/ Retiring allowances and death benefits are discussed in Chapter 7, infra.
- 2/ 6 Tax Cas. (1914), 477.
- 3/ Ibid., p. 485.
- 4/ 13 Tax A.B.C. (1955), 264; 55 DTC 428.
- 5/ [1960] C.T.C. 336; 60 DTC 1236.
- 6/ G.S.A. Wheatcroft, The Law of Income Tax, Surtax and Profit Tax, London: Sweet & Maxwell, Limited, 1962, p. 1410
- 7/ L. E. Coward, "Tax Planning for the Executive", Report of the 11th Annual Tax Conference, Canadian Tax Foundation, 1957, 162 at p. 167.

CHAPTER 6

DAMAGES AND OTHER COMPENSATORY PAYMENTS

PAYMENTS ARISING IN CONNECTION WITH CONTRACTS OF SERVICE

Payments for Rights Voluntarily Surrendered

Section 3 of the Income Tax Act provides that "offices and employments" are sources of income. Ordinarily, an officer or employee receives compensation for the performance of services in the form of salary or wages which clearly constitute income. In a few instances, however, compensation paid by an employer to an officer or employee not in consideration for services but rather in exchange for certain valuable rights, has been held to be capital. For example, in Beak v. Robson ^{1/} the House of Lords held that a payment made to an employee in exchange for a covenant not to compete with his employers after the termination of his employment was not income under Schedule E of the United Kingdom Income Tax Act on the technical ground that the covenant for which payment was made would not become effective unless and until the office had been terminated, and so could not be regarded as having arisen from his "office or employment". The decision may also be rationalized on the ground that the taxpayer gave up certain rights of a capital nature, namely, his freedom of choice in the selection of future employment. ^{2/}

Shortly after the decision in Beak v. Robson, the Parliament of Canada enacted the provisions now found in section 25 of the Income Tax Act which are designed to prevent tax avoidance through the realization of capital

gains in connection with employment contracts. That section provides that where a payment is received during a period while the employee was employed by the payer, or in connection with an obligation arising out of an agreement made between them immediately prior to, during, or immediately after a period of employment, the amount received is deemed to be remuneration for the payee's services rendered during the employment, unless it is established that, apart from the time when the agreement was made or apart from the form or legal effect of the agreement, the amount received cannot reasonably be regarded as having been received (i) as consideration or partial consideration for accepting the office or entering into the contract of employment, (ii) as a remuneration or partial remuneration for services as an officer or under the contract of employment, or (iii) in consideration or partial consideration for covenanting with reference to what the officer or employee is, or is not, to do before or after termination of the employment.

Where pension rights were surrendered by a company director in consideration for a lump sum payment by his employer, the House of Lords held in Tilley v. Wales ^{3/} that the payment was capital, even though the pension payments, had they been received, would have been taxable: "...a lump sum paid to commute a pension is in the nature of a capital payment which is substituted for a series of recurrent and periodic sums which partake of the nature of income". ^{4/} Whether this decision would apply in Canada is doubtful in the light of the provisions of section 6(1)(a)(iv) of the Income Tax Act which requires the inclusion in income of "amounts received in the year as, on account or in lieu of payment of, or in satisfaction of...superannuation or pension benefits...."

The fact that a receipt involves the surrender of certain capital rights does not necessarily mean that some portion of the receipt will be regarded as capital. In Curran v. M.N.R. 5/ the appellant, in consideration for a lump sum payment of \$250,000 paid to him by one Brown, pursuant to an agreement, resigned his position with Imperial Oil Limited, which had long been his employer, and accepted a position with Federated Petroleum Limited, in which company Brown was a substantial shareholder. Under another agreement, signed on the same date, Federated Petroleum Limited undertook to employ the appellant as its general manager, subject to the condition that he should serve as manager of any other company in which Federated Petroleum Limited had a financial interest. Pursuant to this condition, the appellant became the president and general manager of Home Oil Limited. The \$250,000 lump sum payment was assessed by the Minister as part of the appellant's income. The latter objected, contending that the \$250,000 had been received in consideration of the loss of rights to a substantial pension and the giving up of excellent chances for advancement in the Imperial Oil organization. The Supreme Court of Canada held that the payment was made for personal services to be rendered, and so was income under section 3, and was not divisible into income and capital elements. Taschereau J. dissented on the ground that part of the \$250,000 was capital compensation for the loss of valuable rights connected with the former employment and should have been excluded from income.

Compensation for Loss of Office 6/

In keeping with the fundamental rule of Canadian income tax law that payments arising from the realization of a source of income are capital, remuneration received by an employee for loss of his office, where that

office has been terminated by the employer prior to its expiration under the contract of office or employment, has been held to be non-taxable. In Salter v. M.N.R. 7/ it was held that an amount paid by an employer to secure a release by an employee for the unexpired portion of an employment contract was capital. The effect of this decision has been nullified by section 6(1)(a)(v) which requires the inclusion in income of amounts received as "retiring allowances". This expression is defined in section 139(1)(aj) to include an amount received in respect of loss of office or employment. The Income Tax Appeal Board has held that, to come within this definition, the payment must be paid by the employer voluntarily, so that damages awarded against an employer for termination of a contract of employment are not taxable as a retiring allowance. 8/

There seems to be little merit in the rule that compensation for loss of office or employment is taxable or not according to whether it is paid voluntarily by the employer or recovered through judicial proceedings. The remedy appears to lie in amending the definition of "retiring allowance" to include damage payments as well as voluntary payments.

COMPENSATION FOR PERSONAL INJURY AND ILLNESS

Damages for Impairment of Earning Capacity and Loss of Earnings

There is almost a complete dearth of judicial authority on the question of the tax treatment of compensatory payments for impairment of earning capacity and loss of earnings. In the recent case of The Queen in the Right of the Province of Ontario v. Jennings, in which the plaintiff recovered damages for injuries sustained in an automobile accident, Judson J. said:

For what it is worth, my opinion is that an award of damages for impairment of earning capacity would not be taxable under the Canadian Income Tax Act. To the extent that an award includes an identifiable sum for loss of earnings up to the date of judgment the result might well be different. But I know of no decisions where these issues have been dealt with and until this has been done in proceedings in which the Minister of National Revenue is a party, any expression of opinion must be insecure. Such litigation would have to go through the Board of Tax Appeals or direct to the Exchequer Court with a final appeal, in appropriate cases, to this Court. 9/

The court held, disapproving of the decision of a majority of the House of Lords in British Transportation Commission v. Gourley 10/ that there should be no deduction from the amount awarded for lost earnings on the assumption that the plaintiff would have had to pay income tax on the earnings.

Workmen's Compensation Payments

These payments are expressly excluded from income by section 10(1)(g). 11/

Payments by an Employer

Amounts paid by an employer to an employee by reason of the latter's sickness or injury are likely taxable as "other remuneration" or "benefits" from an office or employment under section 5(1)(a).

Payments Received Under Health and Accident Insurance Policies

The express exclusion of workmen's compensation payments from income under the Income War Tax Act led one commentator to inquire

...whether or not other sickness, accident or disability payments are by inference to be considered as taxable income. The practice of the Department, however, is to treat such receipts as exempt in the hands of the recipient.

In the absence of the provisions of this paragraph payments mentioned herein may, perhaps, be regarded as taxable as being "an annual profit or gain from any other source"; on the other hand a lump sum paid to dependents of a wage-earner on account of his death would seem to constitute a receipt of a capital nature. 12/

It is departmental practice to consider payments received under a group insurance or medical service plan as being non-taxable. If benefits arising under health and accident insurance policies were sought to be taxed by the Department, it seems likely that section 3, which taxes "...income...from all sources" would be invoked. However, this provision has been given little content by the courts, as was the case with the counterpart of this provision in the Income War Tax Act, which defined income as including "the annual profit or gain from any other source", so that it seems most unlikely that such benefits would be taxable under the sweeping-up clause. If, however, the payments were made periodically they might fall to be taxed as an "annuity" which is broadly defined in section 139(1)(b) to include "...an amount payable on a periodic basis whether payable at intervals longer or shorter than a year and whether payable under a contract, will or trust or otherwise". Annuities are required to be included in income by section 6(1)(aa). The broad scope of the statutory definition of "annuity" is illustrated in the recent case of Koller v. M.N.R. 13/ which is discussed immediately below.

Compensation for Persecution

The form in which a compensatory payment is made may well determine whether or not it is includible in the income of the recipient. In Koller v. M.N.R., the appellant, a victim of Nazi persecution, was awarded 10,000 marks by West Germany to compensate him, the Tax Appeal Board found,

for the persecution which he suffered and the general upheaval which followed in his life. He elected to receive the award in the form of lifetime monthly payments of 200 marks each. It was held that the payments fell within the words "or otherwise" in the definition of "annuity" and so were taxable, even though, said the Board, a lump sum payment of 10,000 marks would very likely have been treated as capital.

It may have been this decision which prompted the government to enact paragraph (fa) of subsection (1) of section 10, 14/ which excludes from income:

...a payment made by the Federal Republic of Germany or by a public body performing a function of government within that country as compensation to a victim of National Socialist persecution, where no tax is payable in respect of that payment under a law of the Federal Republic of Germany that imposes an income tax.

COMPENSATION FOR PROPERTY
HELD FOR PERSONAL USE

A payment of damages or insurance proceeds in respect of loss of a dwelling, an automobile, jewellery, clothing or other personal assets would seem clearly to constitute indemnity for loss of capital assets and would not be includible in income.

REFERENCES

- 1/ [1943] A.C. 352
- 2/ Compare the similar result reached by the Exchequer Court in a business context in Galipeau v. M.N.R., [1962] Ex. C.R. 284; [1962] C.T.C. 289; 62 DTC 1178. In that case the taxpayer borrowed \$49,600 from an oil company for the expansion of his garage and service station. The oil company agreed to credit \$275 each month against the taxpayer's indebtedness provided he continued to sell its products exclusively, such products to be supplied to him at regular prices. It was held that the monthly credits were given to the taxpayer in consideration for accepting a restriction on his future trading rights and were thus in the nature of capital receipts.
- 3/ [1943] A.C. 386.
- 4/ Ibid., pp. 392-393, per Viscount Simon.
- 5/ [1959] S.C.R. 850; [1959] C.T.C. 416; 59 DTC 1247.
- 6/ For a more comprehensive treatment of this subject, see Chapter 7, infra.
- 7/ [1946] Ex. C.R. 634; [1947] C.T.C. 29; 2 DTC 918.
- 8/ No. 45 v. M.N.R., 5 Tax A.B.C. (1952), 417; 52 DTC 72. See also Brown v. M.N.R., 5 Tax A.B.C. (1951), 279; 52 DTC 9, where it was held that damages recovered by the taxpayer from his employer for wrongful dismissal were a capital receipt paid in respect of the destruction of his contractual rights and did not fall within the definition of "retiring allowance". The amount of the damages fixed by the court was measured by the amount of income which the taxpayer might have expected to receive had he been permitted to fulfill his contract.
- 9/ (1966) 57 D.L.R. (2d) 644 p. 655.
- 10/ [1956] A.C. 185.
- 11/ For further discussion of workmen's compensation payments, see Chapter 9, infra.
- 12/ H.A.W. Plaxton, The Law Relating to Income Tax and Excess Profits Tax of The Dominion of Canada (2nd Ed.), Toronto: The Carswell Company, Limited, 1947, p. 92.
- 13/ 34 Tax A.B.C. (1963-64), 93; 63 DTC 994.
- 14/ S.C. 1964, c. 13, section 2(1).

CHAPTER 7

RETIRING ALLOWANCES AND DEATH BENEFITS

By virtue of section 6(1)(a)(v) and (vi), "retiring allowances" 1/ and "death benefit" 2/ are expressly made taxable under the Income Tax Act. The purpose of this chapter is to consider what nature of payments are included within these terms and to evaluate the tax treatment accorded these payments.

RETIRING ALLOWANCES

Since the term "retiring allowances" includes two distinct types of payments—those in recognition of long service and those for loss of office or employment—and inasmuch as the history of the taxation of these two types of payments has been somewhat different, it will be convenient to deal with each separately.

PAYMENT IN RECOGNITION OF LONG SERVICE

Scope of the Phrase

A consideration of the taxation of payments in recognition of long service must commence with a review of the relevant law prior to August 15, 1944, the date when the special tax treatment accorded to such payments was inaugurated.

It was early recognized that the responsibility for the support of employees during their retirement should rest primarily on employers and

employees rather than on the government. In order to further this policy in the context of progressive taxation, special tax treatment was given to pension plans set up by employers. 3/ Thus, by 1944 the Income War Tax Act allowed employers and employees to deduct from their incomes certain sums paid into approved pension funds or plans. Payments received from the funds by the retired employees or their dependants were taxed in the year of receipt. In case of a lump sum payment out of any such pension fund or plan paid upon the death, withdrawal or retirement of the employee in full satisfaction of his rights under the fund or plan, only one third of such payment was deemed income and taxed in the year of receipt.

Where a payment was made by an employer to an employee upon retirement, apart from any pension plan, if it was for services rendered and not as a gift or testimonial, 4/ it was taxed in the year of receipt. It is thus apparent that a serious tax discrimination existed against employers and employees not enjoying approved pension plans in cases where the employers made lump sum payments with a view to supporting or partially supporting the employees during their retirement.

It was apparently to overcome this inequity that section 3(6) was added to the Income War Tax Act in 1944. 5/ It provided as follows:

Where the Minister is satisfied that a single payment by an employer to an employee upon retirement, other than a payment out of or pursuant to a superannuation or pension fund or plan approved by the Minister, is in recognition of long service, one-fifth only of the payment shall be deemed, for the purposes of this Act, to be income of the taxpayer in the year it is received and one-fifth thereof shall be so deemed to be income of the taxpayer in each of the four succeeding years in which he is living.

Since the legislation provided tax amelioration 6/ through income

spreading it will be useful to consider its ambit; this may be done by examining the six basic elements of section 3(6) of the Income War Tax Act.

First, the payment had to be a single payment. This was designed to obviate the worst aspect of the discrimination. The discrimination, if any, would have been minimal if the payments had been spread over a period of years.

Secondly, the payment had to be made upon retirement of the employee. This clearly indicates that no attempt was made by the section to provide relief merely for lump sum payments and fluctuating income from employment—relief was provided only in cases of retirement from employment.

Thirdly, the section did not apply to payments out of or pursuant to approved superannuation or pension funds or plans, since such payments, as explained previously, already received tax relief.

Fourthly, the payment must have been made in recognition of long service. Clearly, the emphasized words encompassed a gratuitous payment for services rendered. [In fact, the Finance Minister in describing the intent of the legislation stated: 8/

It is proposed to allow those who receive long-service gratuities in a lump sum on retirement from service to to spread the sum over five years for tax purposes.
[Emphasis added.]

It is uncertain whether a payment which was legally enforceable could have come within the scope of the legislation. For example, an employer and an employee may have contracted that upon retirement the employee was to receive a fixed sum of money. Would such a payment have been permitted tax relief under the section?

In Pouliot v. M.N.R. 9/ payments to civil servants pursuant to certain regulations authorizing payments upon retirement commensurate with length of service were admitted to be "retiring allowances". Thus, on the basis of the Pouliot case, it would seem that payments made in fulfilment of legal obligations would be included within the scope of the section. Such a result is both sound and reasonable.

Fifthly, the payment must have been made for long service. The word "long" apparently was used to prevent tax avoidance through successive changes in employment and to make certain that only after long employment and on actual "retirement" would tax relief be provided.

Up to 1965 there appeared to be only one case considering the meaning of "long". Without any extensive analysis it was held in M.N.R. v. Manaster 10/ that a five-month period of employment in the construction industry was not "long"; consequently no tax relief was given to the lump sum payment in question.

The possible emphasis on the word "long" in determining the ambit of the section has been greatly reduced by the 1965 amendments to section 36 of the Income Tax Act which limit the amount to which tax relief will be granted to \$1,000 for each year of employment. This aspect is further discussed below.

Finally, in order to control tax avoidance, the determination of whether or not a payment was made in recognition of long service was left to the Minister's discretion.

The above discussion of section 3(6) of the Income War Tax Act, except the comments on ministerial discretion, is totally applicable to

the present provisions dealing with payments in recognition of long service. However, the two changes that have taken place since the original legislation was enacted have to be considered.

In 1948 the whole Income War Tax Act was replaced by a new act, The 1948 Income Tax Act. In the process of revision the provisions relating to payments in recognition of long service were reorganized. By section 6(a) of the 1948 Act "retiring allowances" were to be included in the computation of income. This provision was similar to the present section 6(1)(a)(v). "Retiring allowances" were then defined in section 127(1)(ai). The definition presented in the 1948 Act was exactly the same as the present one found in section 139(1)(aj) of the Income Tax Act. 11/ Section 34 of the 1948 Act provided for the method of taxing single payments in recognition of long service and was similar to section 36 of the Income Tax Act prior to its modification in 1965.

In the 1948 Act ministerial discretion in the matter of determining what payments were in recognition of long service was removed. This was in conformity with the whole 1948 tax revision programme of eliminating ministerial discretion in the determination of taxable income.

The 1948 revision, moreover, broadened the tax base. Prior to 1948 gratuitous payments made by an employer to an employee's legal representative, relatives or dependants in recognition of the employee's long service would probably not have been taxable. By virtue of the definition of "retiring allowances" in the 1948 Act such payments became taxable.

The reasons for this change are probably twofold. In the first place, it may have been the intention of the government to prevent tax

avoidance through "gentlemen's agreements" between employers and employees whereby the sums could be paid directly to third persons. Secondly, it may have been the intention to treat payments in recognition of long service identically with payments under an approved pension fund or plan. It should be noted that payments of the latter type are taxable in the hands of dependants and relatives.

Manner of Taxation

Once a payment is found to be "in recognition of long service" the manner of its taxation must be considered.

Section 36(1) provides: 12/

In the case of (a) a single payment...(ii) upon retirement of an employee in recognition of long service and not made out of or under a superannuation fund or plan...the payment... made in a taxation year may, at the option of the taxpayer by whom it is...received, be deemed not to be income of the taxpayer for the purpose of this Part, in which case the taxpayer shall pay, in addition to any other tax payable for the year, a tax on the payment...equal to the proportion thereof that (i) the aggregate of the taxes otherwise payable by the employee under this Part for the 3 years immediately preceding the taxation year (before making any deduction under section 33, 38 or 41), is of (ii) the aggregate of the employees incomes for those three years.

The section appears to be fairly straightforward and possible uncertainty or inequity in some areas has been prevented. We note two such areas.

First, if the employee has not been resident in Canada during the relevant three-year period or any part of it, the situation is covered by section 36(2) which allows such a taxpayer to use the above averaging formula by substituting therein the tax the employee would have paid on

his income had he been resident in Canada and his income had come from sources in Canada. This right, however, can only be exercised if the employee files returns for the years in question.

Secondly, by excluding from the above averaging formula any deduction under sections 33, 38 and 41, which respectively allow tax credits for taxes paid to provinces, on certain dividends, and to foreign countries, an attempt has been made to get a truer picture of the federal tax liability of each employee, and thus prevent the formula from discriminating among taxpayers who may have the same total world income but whose sources of income may be different.

Because an average rate of tax is used for taxing the single payment, it can readily be appreciated that tax avoidance is possible if a low income is maintained during the preceding three years and a large lump sum payment is received on retirement in the fourth year. Apparently tax abuse of this nature did occur, and to prevent it section 36(5)(c) was enacted in 1965. 13/

By virtue of section 36(5)(c), the greatest amount 14/ that can be deemed not to be income of the current year and thus taxed on the average rate basis is the product of \$1,000 times the number of years during which the taxpayer was an employee of the employer who made the payment, less the total of (1) any amount which in the previous year the taxpayer elected to tax under section 36, and (2) any amount received under a retirement plan which the taxpayer elected to have taxed under section 36 in the current tax year.

To ameliorate possible inequity to an employee because of employer changes, the basic employment remaining the same, section 36(6)(a) 15/ provides:

(a) where all or substantially all of the property used in carrying on the business of a person who was an employer of an employee (hereinafter referred to as the "former employer"),

(i) has been purchased by a person who, by reason of the purchase, or

(ii) has been acquired by bequest or inheritance or by virtue of an amalgamation within the meaning of section 851, by a person who, by reason of the acquisition,

became an employer of the employee, and who subsequently made a payment of a class described in paragraph (c) of subsection (5) in respect of the employee or former employee, the employee or former employee shall be deemed to have been an employee of that employer throughout the period he was an employee of the former employer;...

In 1965 the tax treatment of payments in recognition of long service was further brought into alignment with that accorded payments under pension plans when section 11(1)(u) of the Act became applicable to retiring allowances. 16/ Under that section an amount received as a retiring allowance but put into a registered pension or retirement plan in the same taxation year or 60 days from the end of the taxation year may be deducted from income. The amount deductible under the section is the portion which cannot be deducted as a contribution to a pension plan under section 11(1)(i) or as a premium under a registered retirement savings plan.

By virtue of section 36(3), any amount deducted under section 11(1)(u) must be deducted from any amount to which section 36(1) can apply. This is designed to prevent a double tax advantage.

Conclusion

The present tax treatment of payments in recognition of long service is basically sound and fairly equitable; little change is needed.

Payments in recognition of long service are made primarily with a view to supporting an employee or his dependants on retirement. The present Act accords such payments virtually the same treatment as it accords lump sum payments under registered pension plans. This result is equitable and reasonable.

A provision might be added to the present system, however, which would permit the exclusion from income of that part of a lump sum receipt which was expended to purchase an annuity. The annuity payments would, of course, be brought into income for tax purposes at the time of their receipt. Such an option, we feel, would add a desirable flexibility and perhaps greater equity to the taxation of payments in recognition of long service.

PAYMENTS FOR LOSS OF OFFICE OR EMPLOYMENT

Scope of the Phrase

Before the addition of section 3(8) to the Income War Tax Act in 1945 which, for the first time, expressly provided for the taxation of payments for "loss of office or employment", the Canadian and British courts had developed a jurisprudence concerning such payments which has to be considered at the outset in order to understand and evaluate the subsequent legislation. The following major cases may be considered.

In Salter v. M.N.R. 17/ the taxpayer had a five-year contract of employment at a salary of \$15,000 a year. Shortly after the contract was entered into differences arose, and for the sum of \$15,000 the employee agreed to release the employer from further obligations under the contract. The Exchequer Court of Canada held that the sum was of a capital nature and thus not taxable. The reasoning of the Court was in essence that the

contract of employment was to be regarded as the capital or the "tree" which produced the wages or the "fruit", and, therefore, since the taxpayer was giving up a capital asset, the money he was receiving in return was of a capital nature.

It should be noted here that the sum in question was not greater than \$75,000 (5 years x \$15,000 a year). It would have been an interesting question if the sum paid were, say, \$100,000. In such a case it would have been necessary to determine whether the \$25,000 (the difference between \$100,000 and \$75,000) was still a payment for a capital asset, or whether it would have been treated either as a gift or as a payment for services rendered. Probably a court would have considered the \$25,000 to be either a gift or a payment for services rendered but not a capital receipt.

In Henry v. Foster 18/ the company's articles provided that, in the event that any director who had held office for at least five years ceased to hold office, the company would pay him or his representative by way of compensation for "loss of office" a sum equal to the total remuneration received in the preceding five years. The taxpayer who was a director voluntarily resigned after more than five years' service and was paid a lump sum pursuant to the articles. The English Court of Appeal held that where a person resigns from office or dies, the payment cannot be for "loss of office", but must be for services rendered, or a gift. The Court then held that in this case it was for services rendered and as such it was taxable.

In Pouliot v. M.N.R. 19/ the Tax Appeal Board also held that a payment made after an employee resigned because of ill health could not be for "loss of office".

In Fullerton v. M.N.R. 20/ the taxpayer was appointed to a statutory office for a five-year period at a salary of \$30,000 a year. After three years the office was abolished by legislation. Thus, in law he was entitled to no further salary. However, an order in council was issued granting him \$30,000. The Exchequer Court of Canada held that the amount was capital in nature as being a payment for "cessation of his office".

It is exceedingly difficult to believe that the Court based its decision on the ground that the payment was a "gift" or a "testimonial". It must therefore have based its decision on some notion of the deprivation of a capital asset or office. Therefore, in order to reconcile the Fullerton case with the Salter and Henry cases in principle, it must be considered as holding that a voluntary payment made in circumstances where the contract has been rendered unenforceable, for reasons other than the employee's inability to carry out his obligations, is of a capital nature and in essence is for "loss of office or employment".

Finally, one other case should be considered in this context, although it arose after section 3(8) of the Income War Tax Act was enacted. In Brown v. M.N.R. 21/ the taxpayer had a contract of employment but was dismissed by his employer in breach of the contract. He brought legal action and was awarded damages calculated on the basis of what he would have earned had he not been wrongfully dismissed. The Tax Appeal Board held that the damages so awarded could not be considered as payment for "loss of office or employment" as the payment was not made voluntarily, but should be considered as a capital receipt in the hands of the recipient. If the Brown case is good law, it would probably also follow that if the payment in that case were made as a result of a threat of

court action it would lose its character as a payment for loss of office or employment as not being "voluntary" and become another form of capital receipt.

It is submitted, however, that the Brown case was wrongly decided. No valid reason was put forth in the case as to why a payment which was clearly for loss of office or employment should have acquired a different character merely because judicial proceedings intervened. It should be noted that in cases involving arrears of wages, where resort has to be made to the courts for enforcement of the contract, no change in the character of the amount paid pursuant to the court order is recognized—the amount is still taxable as wages received.

In summary, on the assumption that the Brown case was wrongly decided, the following principles of law as they existed prior to 1945 can be stated: a payment by an employer to an employee or ex-employee was a payment for loss of office or employment and, as such was a capital receipt if it was made in order to relieve the employer of a legal obligation to employ the employee, or if it was made voluntarily but only in circumstances where the contract of employment had become unenforceable for reasons other than the employee's inability to perform his duties. The payment, however, in all cases must have been no larger than what the employee would have received had he worked until the contract of employment had expired or had been legally terminated by the employer. If it was larger than this sum, the excess amount was either a gift or a payment for services rendered.

Section 3(8) of the Income War Tax Act had the effect of making taxable payments for loss of office or employment which had been judicially

considered as capital receipts. It did, however, provide tax relief by allowing the sum received to be spread over a five-year period if the Minister determined it to be a payment for loss of office or employment.

The taxation of payments for loss of office or employment stemmed from the recommendation of the Ives Commission. 22/ In this regard the Commission stated: 23/

It has been brought to our attention that the present tax law has been interpreted by the Courts as recognizing a distinction between payments made by an employer in recognition of past services and payments made in the nature of compensation or indemnity for loss of office. This distinction, we feel, is somewhat artificial and unless the law is changed there may be an inducement, by the simple expedient of wording of agreements, to arrange for such payments as are to be made to come within the definition of compensation for loss of office. Compensation to an individual for loss of office is essentially an indemnity for loss of prospective earnings—and where the payment is made by an employer to an employee there is no justification for placing the recipient in a more advantageous position than he would have been had the indemnity not been necessary. We would, therefore, recommend that all lump sum payments made by an employer to an employee on cessation of employment be given the same treatment.

It should be pointed out that, if the jurisprudence on payments for loss of office is properly understood, a distinction can readily be discerned between such payments and payments for services rendered. Moreover, such a distinction is logical in a tax philosophy which exempts capital gains from taxation. Therefore the Ives Commission's statement that the distinction is "artificial" is somewhat unjustified.

The taxation of payments for loss of office or employment, however, may be readily justified on the principle that all receipts by an individual should be taxable and that for tax purposes no distinction should be made between income and capital receipts. It is on this basis that the taxation of payments for loss of office or employment is sound.

As explained in the discussion on the taxation of payments in recognition of long service, a basic tax revision occurred in 1948 with the enactment of The 1948 Income Tax Act. By virtue of the revision, ministerial discretion in determining what payments were for loss of office or employment was eliminated, in conformity with the general policy of eliminating ministerial discretion in the determination of taxable income.

As a result of the 1948 revision, which provided a definition of "retiring allowances" and thus grouped payments in recognition of long service and payments for loss of office or employment under one heading, it would appear on first sight that a payment for loss of office or employment could be considered income in the hands of the employee's legal representative, relatives, or dependants. However, if one considers the legal nature of a payment for loss of office or employment it is quite apparent that that cannot be the situation—it can only be income in the hands of the employee, or in the hands of his legal representative in a case where the legal representative is merely receiving or enforcing debts or obligations already due to the employee. It would thus follow that an amount received by a "dependant, relation or legal representative" is taxable as a "retiring allowance" as defined in section 139(1)(aj) only if it is a payment in recognition of long service, and not if it is a payment for loss of office or employment.

Manner of Taxation

With one exception, payments for loss of office or employment are taxed in the same way as payments in recognition of long service. Consequently, the previous discussion in this regard can be applied mutatis mutandis.

The only difference between the taxation of payments in recognition of long service and payments for loss of office or employment is that the latter type of payments need not necessarily be in a single lump sum in order that section 36(1) be applicable. However, section 36(1) is restricted to payments made in the year of retirement or within one year of retirement.

Conclusion

The taxation of payments for loss of office or employment can readily be justified if the general principle that all net accretions to wealth should be taxable is adopted. In this regard, if the Brown case is judicially upheld it will be necessary to amend the Act so as to include damages awarded by a court for wrongful dismissal from an office or employment.

It is difficult to devise a method of taxing payments for loss of office or employment which would be non-discriminatory in all cases, would be easy to administer, would not be too complex and would not deprive the government of deserved revenue. In most instances a payment for loss of office will arise in circumstances similar to those which obtained in the Salter case. Applying a three-year average tax rate would, therefore, produce fairly equitable results and would be fairly easy to administer. It might, therefore, be concluded that the tax treatment of payments for loss of office or employment prior to 1965 was fairly sound.

The 1965 amendments to section 36 introduced a limitation on the amount to which the average tax rate could apply. The limitation is based

on length of the period of employment. It can readily be appreciated that such a limitation could be most useful in the taxation of payments in recognition of long service, but in the taxation of payments for loss of office or employment it leads to perverse results. For example, Executive A enters into a contract of employment with Company X for 5 years at a salary of \$10,000 per annum. Company X may decide it does not need A and may wish to relieve itself of its legal obligations. In the circumstances, the longer A works the less value his unexpired contract has. Under the tax provisions, however, the longer a person works with an employer the greater is the amount to which the average rate can be applied.

Moreover, the limitation of \$1,000 for each year of employment is totally unrelated to what the salary level is. Thus, in the example above, which is a realistic one, if A worked for one year and then received a \$10,000 lump sum payment for agreeing to terminate the contract, he would only be able to claim \$1,000 for purposes of section 36(1), the remaining \$9,000 being subject to the usual rates of tax. This is grossly unjust, particularly at the present time when other forms of capital receipts are non-taxable.

To remedy the inequity caused by the 1965 amendments in so far as they apply to payments for loss of office or employment, it is mandatory that one or more of at least three possible alternatives be adopted. First, the limitation based on length of employment might be repealed. Secondly, a general averaging provision might be enacted for all types of fluctuating or lump sum income. Thirdly, as was recommended in the case of payments in recognition of long service, a provision might be added whereby a lump sum payment, to the extent that it was expended to purchase an annuity, would be excluded from income.

DEATH BENEFITSScope of the Phrase

In 1950 section 6(a)(vi) was added to The 1948 Income Tax Act, 24/ providing that a "death benefit" was to be included in the computation of a taxpayer's income. Section 6(1)(a)(vi) of the present Act is identical to that section. "Death benefit" is defined in section 139(1)(j) of the present Act in part as:

...the amount or amounts received in the year by any person upon or after the death of an employee in recognition of his service in an office or employment minus...

At least two points should be noted from an examination of this definition. First, apart from the omission of the word "long", it closely resembles a payment "in recognition of long service" which is taxable as a "retiring allowance" under section 6(1)(v). In the discussion of payments in recognition of long service it was indicated that the word "long" was used primarily to prevent tax avoidance by employees. In the case of a death benefit—the employee being dead—such tax avoidance is impossible, and consequently it is not necessary to retain the word "long". It thus would seem that a "death benefit" is a type of "payment in recognition of long service" except that it must be received on the employee's death; only in the highly unlikely event of a person other than a relative receiving a payment in recognition of an employee's services would the payment be a "death benefit" but not a "retiring allowance".

Secondly, it should be noted that whereas pension or superannuation benefits are excluded from the definition of a payment in recognition of long service, no such exclusion is provided in the definition of a death

benefit. It may well be that a court would hold that a superannuation or pension benefit fits within the definition.

It thus follows that the 1950 legislation which made "death benefits" taxable really did not extend the tax base. Having regard to the manner in which death benefits are taxed, which is discussed immediately below, it would seem that it was Parliament's intention in enacting the legislation to further reduce the tax burden on relatives and other dependants of an employee who receive income arising by virtue of the employee's services.

Manner of Taxation

Under the definition of "death benefit", 25/ certain sums are deductible in determining the taxable quantum. Death benefits received from each office or employment are to be treated separately; the total subtractible sum is the same as it would be if all amounts had been received from one office only. Where the sum is received by a widow, and there has been an amount deducted for previous death benefits from any office or employment then the subtractible amount is the lesser of (a) the amount or amounts received or (b) an amount equal to the employee's remuneration for the last year in that office or \$10,000, whichever is lesser, minus amounts deductible in computing for previous years the death benefits received in respect of his service in that office or employment.

Where an employee dies without leaving a widow, or where no amount is deductible by his widow in computing for any year the death benefits in respect of his service in that or any other office or employment, the subtractible amount is the lesser of (c) the amount or amounts so received or (d) that proportion of any amount determined as in (b) above, that the

amount or amounts so received are of the aggregate of all amounts received in the year by each of the persons who received any such amount or amounts, upon or after the death of the employee in recognition of his service in that office or employment.

Once the taxable amount of a death benefit is determined, section 36(1)(c) may be used; thus it is possible to exclude such sum from income and apply a three-year average tax rate to it. It is to be noted that the 1965 amendments to section 36 which limit its operation do not apply to death benefits.

In order that death benefits should not be subject to both the income tax and death duties, section 11(1)(v) and section 36(4) were added to the Income Tax Act. Section 11(1)(v) permits the deduction of the federal estate tax and provincial succession duties. The amount deductible in respect of any payment of a death benefit is that part of the federal estate tax and provincial succession duties payable in respect of the property giving rise to the benefit that the portion thereof referable to the payment is to the total value of the benefit which was subject to estate tax or succession duties. By virtue of section 36(4) if the option is exercised under section 36 then the amount deductible under section 11(1)(v) must be subtracted for the purpose of calculating the tax due.

Conclusion

Under the present system it is obvious that death benefits should be taxed. There is also probably some justification for reducing the tax burden on the recipients of these payments in order that they may provide for themselves after the death of their source of support—the employee.

However, under a system which imposes both income and estate taxes it is difficult to determine the kind and degree of relief that should be provided. Whether the present provisions are adequate is far from certain. Since the \$10,000 figure is a maximum sum, it should be periodically reviewed.

REFERENCES

1/ Section 139(1)(aj) provides: "'retiring allowance' means an amount received upon or after retirement from an office or employment in recognition of long service or in respect of loss of office or employment (other than a superannuation or pension benefit), whether the recipient is the officer or employee or a dependant, relation or legal representative."

2/ Section 139(1)(j) provides: "'death benefit' for a taxation year means the amount or amounts received in the year by any person upon or after the death of an employee in recognition of his service in an office or employment minus

(i) where the amount or amounts were received by his widow, the lesser of

(A) the amount or amounts so received, or

(B) an amount equal to the employee's salary, wages and other remuneration for the last year in that office or employment for which he received any such remuneration or \$10,000, whichever is the lesser, minus amounts deductible in computing for previous years the death benefits received in respect of his service in that office or employment, or

(ii) where the employee died without leaving a widow or where no amount is deductible in computing for any year the death benefits received by his widow in respect of his service in that or any other office or employment, the lesser of

(A) the amount or amounts so received, or

(B) that proportion of any amount determined as provided in clause (B) of subparagraph (i) that the amount or amounts so received are of the aggregate of all amounts received in the year, by each of the persons who received any such amount or amounts, upon or after the death of the employee in recognition of his service in that office or employment,

except that where any death benefits were received in the year in respect of the services of an employee in more than one office or employment,

(iii) this paragraph shall be read as requiring a separate determination of the death benefits received in respect of his service in each particular office or employment, and

(iv) there shall be substituted for the amount determined under clause (B) of subparagraph (i) or clause (B) of subparagraph (ii), as the case may be, in respect of each particular office or employment an amount equal to that proportion of the amount otherwise determined thereunder that the employee's salary, wages and

other remuneration for the last year in that particular office or employment for which he received any such remuneration is of the aggregate of his said remuneration for the last years in each of the said offices or employments from which he received any such remuneration..."

3/ For a consideration of the historical development of the taxation of payments under superannuation or pension plans up to 1944 see the Report of the Royal Commission on The Taxation of Annuities and Family Corporations, Ottawa: King's Printer, 1945, pp. 32-43.

4/ A gift or testimonial was not taxable in the hands of an employee. An employer, on the other hand, could not deduct it from his income. Whether a payment made by an employer to an employee is for services rendered or is a testimonial has been considered on many occasions and considerable jurisprudence has arisen in this regard. One of the best statements on this question is by Rowlatt, J. in Mudd v. Collins, 9 Tax Cas. (1925), 297, where he said at pp. 300-301:

"When a man is given a testimonial because of his work in the past, not directly remunerating him for that work, but recognising how high a regard has been held for him in the association of people with him arising out of the performance of those services, and people recognise the good qualities he has and how zealous and kind he has been and how eager to advance the interests of his employers or his parishoners or his constitutents, or whatever they may be, and they say, 'We would like to give you something as a mark of our esteem and regard', that is a testimonial. But where a man does a business operation of this kind which he could not be called upon to do, but it is a business operation and would have to be paid for handsomely if done by somebody else, and it is said 'One of our directors did it for us and he ought to have something besides his fees as director because of this', that seems to me to be paying him for his services...."

5/ S.C. 1944-45, Chapter 43, section 2.

6/ It is quite certain that there was no intention in enacting section 3(6) to expand the tax base in any way, for example, to include testimonials. Thus, in the Supreme Court of Canada decision in Goldman v. M.N.R., [1953] 1 S.C.R. 211, the possibility of a tax-exempt testimonial under the Act was still recognised.

7/ See No. 265 v. M.N.R., 13 Tax A.B.C. (1955), 56; 55 DTC 301.

8/ House of Commons Debates, 1944, vol. 4, p. 4178.

9/ 11 Tax A.B.C. (1954), 203; 54 DTC 407.

10/ [1958] C.T.C. 244; 58 DTC 1144.

11/ See reference 1/.

- 12/ Originally, the lump sum payment was spread over a five-year period. However, in the event of an employee's death or insolvency the government in some cases lost revenue. To overcome this a one-year average tax rate provision was adopted in 1946. In 1951 the present three-year average tax rate provision was adopted.
- 13/ S.C. 1965, Chapter 18, section 10(2).
- 14/ The actual amount may, of course, be lower.
- 15/ S.C. 1965, Chapter 18, section 10(2).
- 16/ Ibid., section 2(1).
- 17/ [1947] C.T.C. 29; 2 DTC 918.
- 18/ 16 Tax Cas. (1931), 605.
- 19/ 11 Tax A.B.C. (1954), 203; 54 DTC 407.
- 20/ [1938-39] C.T.C. 207; 1 DTC 484.
- 21/ 5 Tax A.B.C. (1951), 279; 52 DTC 9.
- 22/ Report of the Royal Commission on the Taxation of Annuities and Family Corporations, Ottawa: King's Printer, 1945.
- 23/ Ibid., p. 44.
- 24/ S.C. 1950, Chapter 40, section 1(1).
- 25/ See reference 2/.

CHAPTER 8

SCHOLARSHIPS, FELLOWSHIPS, BURSARIES, PRIZES AND AWARDS

There are no provisions in the Income Tax Act that deal specifically with scholarships, fellowships, bursaries, prizes and awards. The application of general principles of taxation to such receipts has been considered in a handful of cases, and, in addition, Information Bulletin No. 24 sets out departmental practice with regard to certain awards to employees. These are discussed below and résumés are given of United Kingdom and United States treatment of such receipts.

SCHOLARSHIPS, FELLOWSHIPS AND BURSARIES

In Armstrong v. M.N.R. 1/ a physician, engaged in medical research at a university, received a \$5,000 medical research fellowship for one year, which had been arranged by the university with an insurance officers' association. To qualify for the fellowship the recipient had to be associated with a recognized university which had proper facilities for research. The physician was not a paid member of the staff; in return for the use of the facilities he lectured to medical students, as required by the university regulations governing awards of fellowships. The amount of the fellowship, while received in a lump sum by the university, was paid to the doctor in instalments. The Income Tax Appeal Board held the fellowship to be income from an employment, and not a gift as argued by the taxpayer. Although he was at liberty to conduct his research as he saw fit, he was "at least connected with the University, even if in a somewhat casual way" and had to lecture there. He received his fellowship funds from the university authorities who observed his progress and reported to the donors of the fellowship.

The facts in Cherniack v. M.N.R. 2/ were very similar to those in the Armstrong case except that the fellowship money was advanced by a charitable foundation. It was held that the source of the funds had no bearing on the matter; what was significant was the fact that the fellowship was paid to the recipient "as remuneration for particular work or service rendered, or to be rendered by him", and thus was income from employment.

In McLuhan v M.N.R. 3/ a university professor, while on leave of absence from his university with part salary, undertook a research project sponsored by a United States organization for which he received a grant of \$5,000 and reimbursement for his out-of-pocket expenses. The grant was held to be neither a bursary nor a gift but rather remuneration from employment and taxable under section 5(1) of the Act, as it was given to him at his own request as compensation for the loss of salary from the university.

In Gregory v. M.N.R. 4/ the appellant became an employee of a provincial government as a low-paid psychiatric interne on the same day that he was granted a bursary to pursue advanced psychiatric training at a university. Bursary funds for psychiatric candidates were made available by the federal government to the provinces under the National Health Grants Program but were administered by the provinces. During the period that he was enrolled as a full-time postgraduate student his salary as a psychiatric interne continued in a reduced amount, but the combined amount of the salary and the bursary, both of which were paid by the province in one monthly cheque, was equal to the amount he would have received as salary as an interne had he not obtained the bursary. His contributions to the

civil servants' pension fund were determined on the total amount received by him. Further, he had bound himself to remain in the service of his employer after graduation for a period equal to the period he attended university. The appellant argued that the bursary could not have formed part of his salary as it was received from the federal government, the provincial government being only an agent for the latter in this case. Mr. Fabio Monet of the Income Tax Appeal Board held that the bursary was a taxable allowance received by an employee within the meaning of section 5(1)(b); alternatively, it was consideration for his entering into a contract to work for the provincial government upon graduation and therefore taxable under section 25. The fact that the bursary was paid by the provincial government out of funds received from the federal National Health Grants Program was immaterial since no relationship was thereby created between the recipient and the federal government.

A similar result was reached in Thomson v. M.N.R. 5/ but on narrower grounds. In this case a physician who was employed by a provincial health department received a bursary to enable him to take postgraduate studies in psychiatry. The bursary was found not to have been received because of his previous employment or on condition that he return to this employment, for he had obligated himself only to return to practice psychiatry within the province, not to return to his employment with the health department, although he did in fact do so. The health department did not exercise any control over him while he was studying, nor did he perform any duties for the health department during this period. Nevertheless, the Board found that his employment with the provincial government had not ceased. He had not resigned his position when he accepted the bursary, and pension fund contributions and income tax payments continued to be deducted; these facts

indicated that he had not completely severed his ties with the provincial health department. The bursary payments received by the appellant were income from employment.

In Johnston v. M.N.R. 6/ on the other hand, a different conclusion was reached by Mr. W. S. Fisher on the ground that when the taxpayer applied for a bursary for psychiatric training he was not an employee of the province and that under the bursary agreement he had obligated himself to engage in employment within the province for a stated period and not specifically as an employee of the provincial government. As a consequence

...the bursary payment received by this appellant was not taxable in his hands as income. It was not received by him from an office or employment, since he did not occupy any office and he was not the employee or servant of anyone during the period when he was in attendance on his postgraduate course. It was not income from a business or from property.... The payments received under the bursary were somewhat in the nature of voluntary payments or gifts, wholly unconnected with any office or employment, or with any services, past or present, which had been rendered to the [provincial government]. 7/

This decision was followed in Robinson v. M.N.R. 8/ where a doctor who had been in the employ of a provincial department of health resigned from his employment when he commenced his postgraduate studies. Not only were the bursary payments held to be voluntary payments or gifts, but so also were additional monies paid to him monthly by the provincial government to assist him financially while he pursued his studies!

Summary of Canadian Law

From the cases the following principles of Canadian taxation emerge.

1. When a recipient must perform certain duties or render certain

services under the terms of a grant, or the institution so stipulates in its scholarship, fellowship or bursary programme, then a master and servant relationship is established and all amounts received are income from employment. Postgraduate teaching fellowships would be the most common grant of a taxable nature. No apportionment has been made of the amount of the grant between payments for services rendered (a taxable element) and payments by way of gift to pursue higher studies or research (a non-taxable element). The total amount of the grant under these circumstances is taxable as income from employment. The fact that the funds for a scholarship, fellowship or bursary are made available by a charitable organization does not alter this principle. The corollary is that if the recipient need not perform any duties or render services under the terms of his scholarship or fellowship, he is not placed in a master-servant relationship and is not taxable on the amounts he receives. Most undergraduate scholarships and bursaries would be of this nature.

2. The taxability of bursaries paid by an employer—in the litigated cases, a government—is dependent on whether the recipient remains in the employ of the employer during the time he is pursuing the studies for which the bursary is received. If he remains an employee, the bursary is income from employment; if he does not, then the bursary is received as a non-taxable gift or grant.

The Canadian Tax Foundation has discussed the taxability of scholarships in the following terms:

There are half a dozen different kinds of scholarships, which may be described as progressing by stages from the sort which unquestionably should not be taxed to those which equally unquestionably should.

The first stage is the sort of scholarship which a school or university gives automatically every year for proficiency in the student's ordinary work. The recipient gets the award without making any kind of application for it, and wins it in full competition with every other student and simply because he is that year's best student.

The second stage is that of the scholarship for which application must be made, though the work is, as in the first group, a part of the student's regular work. Here competition is not open, but is confined to applicants. Intra-university scholarships, or such awards as the M.L. Gordon Fellowship given by the Canadian Tax Foundation, are examples of this type.

The third kind diverges a little from the purely academic status of the first two, and includes scholarships given by certain bodies or associations for special work which is not part of the regular work of the student or applicant; and a corollary often appended to this is the stipulation that the donor may have the use of the winning work. An example is the prize given by the Canadian Bar Association for the best essay of the year, the Association reserving the right to publish the essay.

The fourth stage in the progression dilutes still further the purely academic element. An award is given for some special type of work, which may be done under direction or not, but which is not done "in vacuo", since it is hoped that the results will directly benefit the donor of the award. Certain types of industrial research scholarships obviously fall within this class.

Fifth comes a development of stage four, where the work may still be under direction or not, but where the payment bears a direct relationship to the work done. In other words, the award is paid not in a lump sum but periodically or by instalments, as certain stages of the work are completed.

Last comes the stage where the academic element has almost entirely disappeared. Some large concern or institute gives a scholarship for work done on some definite project of its own, the work is done under direction and results furthering the work of the donor are expected and paid for.

Now at some point in this progression, a gift becomes income, and taxable. This is the point at which the relationship of master and servant enters, the point at which the money becomes the proceeds of an office or employment. Just where it occurs

may vary with the individual circumstances of the case, and is a fine question to decide. The point probably first occurs in stage four, with more and more cases in stage five joining the income rather than the gift side, while stage six will be almost entirely on that side. 9/

United Kingdom Treatment

Section 458 of the United Kingdom Income Tax Act of 1952 provides that income from a scholarship held by a person receiving full-time instruction at a university, college, school or other educational establishment is exempt from income tax. A "scholarship" includes an exhibition, bursary or any similar endowment. The Commissioners of Inland Revenue may consult with the Minister of Education (in Scotland the Secretary of State, in Northern Ireland the Governor) to determine if any income is within the exemption.

Thus, scholarships are wholly exempt, provided the recipient can bring himself within the express wording of the section. If he cannot, the quality of the payment will be decided according to general principles of income tax law, which are similar to Canadian law. More specifically, if the amount represents remuneration for services, it will be taxable, but otherwise will likely be regarded as a tax-free gift or windfall.

United States Treatment

Section 117 of the United States Internal Revenue Code provides a general rule that amounts received as scholarships or as fellowship grants, including the value of contributed services and accommodations (for example, room, board and laundry) which are received as part of the scholarship or fellowship, are excludible from gross income. The exemption

also applies to amounts received for incidental expenses for travel, research, clerical help or equipment which are incidental to the scholarship or fellowship to the extent that they are actually expended for those purposes by the recipient.

Section 117 makes a distinction between recipients who are candidates for degrees and those who are not. The exemption, in the case of candidates for degrees, is limited to scholarships and fellowships at "an educational institution which normally maintains a regular faculty and curriculum and normally has a regularly organized body of students in attendance at the place where its educational activities are carried on". 10/

The exclusion does not apply to that portion of a scholarship or fellowship at an educational institution received by candidates for degrees which represents payment for teaching, research or other services in the nature of part-time employment required as a condition of the scholarship or fellowship. If, however, teaching, research or other services are required of all candidates for a particular degree (whether or not they are in receipt of such grants) such services are not to be regarded as part-time employment. An example would be part-time practice teaching as a prerequisite for a degree in education.

In the case of individuals who are not candidates for degrees at an educational institution (for example, post-doctorate scholars) the exemption is limited to \$300 monthly for 36 months (not necessarily consecutive) provided the grantor of the scholarship or fellowship is a tax-exempt organization organized and operated exclusively for religious, charitable scientific, educational or certain similar purposes; a foreign government; an international organization; a binational foundation or commission created

under the Mutual Educational and Cultural Exchange Act of 1961; or is the United States federal government or a local government unit. If such a student receives more than \$300 monthly under his scholarship or fellowship, he is taxable on the excess, whether it is received in a lump sum or in instalments.

Conclusions

In Canada the decisions rendered by the Tax Appeal Board, based on general principles of taxation, have led to incongruous results. In particular, the continuation of a master and servant relationship during periods of full-time academic training ought not to be determinative of the quality of a receipt. It would be more equitable to treat all purely academic grants in the same manner, either exempting them all, or taxing them all. Or, perhaps certain academic grants that include an element of compensation for part-time services could be apportioned, as is the United States practice. In any case, a provision in the Income Tax Act which would clearly spell out the intention of Parliament regarding the status of scholarships, fellowships and bursaries might eliminate the incongruities.

AWARDS AND PRIZES

Awards made to employees for suggestions which lead to a better quality product, increased output or improved operations are taxable in their hands since they constitute remuneration for additional work for the employer. If, however, the true nature of a receipt under a suggestion award plan is determined to be consideration for the sale of an asset such as an invention, then it is probably a capital receipt. Furthermore, Information Bulletin No. 24 states that any prize won by an employee in recognition of job performance constitutes a taxable benefit from employment. 11/

The recent decision of the Exchequer Court in M.N.R. v. Gagnon 12/ considered the taxability of an award received by a civil servant for his suggestion which led to an improvement in the preparation of census figures, a service outside of his regular duties. The award was paid under the Suggestion Award Plan of the Public Service of Canada, authorization for which is found in section 7 of the Financial Administration Act 13/ which provides for a payment to an employee in addition to his authorized salary. The Suggestion Award Plan is designed to reward civil servants for suggestions which increase efficiency or effect economies in the public service. In holding that the award was a receipt of income from employment Jakkett, P. made the following observations:

...all... awards [made under the Suggestion Award Plan Regulations] must be "compensation or other rewards" for "suggestions for improvements" ...the character of the payment involved is determined by the terms of the statute by which it is authorized. These awards must be "compensation" or "rewards" or they are not authorized by the statute...a payment for a suggestion is a payment for a service.

While there may be exceptions...a payment for a service is ordinarily "income" from one of the recipient's "sources" within the meaning of these words in section 3... whether the recipient receives the payment as an employee, as a person who operates a business of supplying services or as a person who has performed a service on an isolated occasion...awards under the Suggestion Award Plan Regulations are income from an employment and fall within section 5 of the Income Tax Act because they are payable to employees of the Government of Canada for services performed for that Government. It is immaterial...that the particular services are not performed in the course of the execution of the normal duties of their positions. Parliament has expressly authorized awards as extra reward or compensation to be paid to public servants for services performed in addition to their normal duties. Such awards are... clearly within the words "other remuneration" in the introductory words of subsection (1) of section 5. 14/

The taxability of a prize or award depends, of course, on what it really represents. In Mansfield v. M.N.R. 15/ the taxability of an award received by an employee for an invention was at issue. An electrical

engineer employed by the civil service invented a piece of mine-sweeping equipment largely on his own time. The invention had been determined by his department not to have come within the scope of his duties of employment. As a public servant he was required by law to assign all his rights in the invention to the Crown and ultimately he received an award of some \$2,900 for it. The Board held that the award was payment in respect of a compulsory transfer to the Crown of rights in an invention and constituted a non-taxable capital receipt and not income from employment under section 5(1). Neither was it a gratuity nor a benefit "of any kind whatsoever...received...in the course of" his employment, within the meaning of section 5(1)(a). The words "other benefits of any kind whatsoever" have to be read ejusdem generis with the preceding words, said W. S. Fisher, Q.C., and thus form part of the phrase "the value of board, lodging, and other benefits of any kind whatsoever"; they indicate a receipt of a benefit in a form other than cash, upon which it is necessary to put some valuation.

The taxability of prizes and awards in the hands of taxpayers carrying on business has also arisen for judicial determination. In Rother v. M.N.R., 16/an architect received \$2,000 as one of six participants selected to enter the final stage of a competition for a design for the National Gallery of Canada. He was not an officer or employee of the National Gallery of Canada or of the Government of Canada. The Board held that he did not receive the money as a payment for services rendered, as a fee, or as the purchase price of the design submitted, for under the terms of the competition, all the designs other than the final winner, were to be returned to the participants. The payment was in the nature of a non-taxable prize or gratuitous award received at a certain stage of a competition; the awards carried with them an element of chance since the

winning designs would depend not only on their intrinsic merit, but on their meeting with the approval of the jury members who might have strong preferences or prejudices and likes or dislikes of which the contestants were unaware.

The opposite result was reached by the Exchequer Court in the recent case of Watts v. M.N.R. 17/ The facts were that Central Mortgage and Housing Corporation sponsored a housing development competition for the architectural profession in general and offered a prize of \$15,000 for the best design. Watts registered and submitted competition drawings pursuant to its terms. He was subsequently advised that he was one of five persons chosen to compete in a run-off competition to determine the final winner. This was not in accordance with the original competition but was in effect an amendment to it. Watts accepted the revised terms and received \$4,000 at this first stage. He re-submitted drawings and was chosen the final winner, for which he received \$15,000—the sum offered in the competition prior to its amendment. The Exchequer Court ruled that both amounts were income received by Watts in his "business" as an architect. As a matter of law, entering the competition and filing drawings in accordance with the terms of the competition and the amendment to it created a contractual relationship. The payments constituted a discharge of the contractual obligations to pay these sums for services rendered under the competition contracts.

In Campbell v. M.N.R., 18/ a professional swimmer entered into a contract with a newspaper to attempt to swim Lake Ontario and to give the newspaper exclusive rights to the story of the swim. If she successfully completed the swim the newspaper was to pay her \$5,000. When only about

half a mile from completion of the swim she was taken from the water on her coach's instructions. The newspaper paid her the \$5,000 in recognition of her magnificent effort although it was not legally obligated to do so. When the Minister taxed the \$5,000 as income, the appellant argued that it was a non-taxable personal gift. The Tax Appeal Board declared that under the agreement the newspaper, for promotional purposes, contracted with the appellant for the exclusive use of her services as a professional swimmer. Even though she was not successful, the newspaper felt obligated to pay the \$5,000 for the services she had rendered exclusively to it: "...the true nature of this transaction was the performance of services for which payment was made. The money was paid in respect of services performed by Miss Campbell in a business context." Thus, even a voluntary payment is taxable as income if made as remuneration for services rendered.

A prize received as a windfall and not as remuneration for services or in the course of business activities has been held not to be taxable. In Abraham v. M.N.R., 19/ an owner of an IGA food store, by agreement, purchased his merchandise from the exclusive distributor and administrator of IGA in his city. During 1957 free tickets for a draw on an automobile were sent by IGA with each delivery of merchandise to IGA merchants, who then signed the tickets and returned them. The appellant won the draw but, since he already owned an automobile, he requested and received \$2,276 in cash instead of the car. The Minister ruled that the money was received by virtue of the appellant's being in business as an IGA dealer and that it was part of his taxable profits. The Tax Appeal Board declared the sum to be a non-taxable prize. The car was won by pure chance. The nature of the prize was not changed by the substitution of money for the car.

United Kingdom Tax Treatment

There appear to be no United Kingdom cases in which prizes or awards were sought to be taxed. In the absence of any specific statutory provisions dealing with such receipts they would be taxable, according to general principles of tax law, if they constituted remuneration for services or business receipts, but not otherwise.

United States Tax Treatment

Section 74 of the Internal Revenue Code establishes that prizes and awards are generally taxable. Section 74(b) provides a statutory exemption for achievement awards if the recipient is selected without his entering a contest and if he need not render substantial future services as a condition. The achievement exclusion does not exempt "prizes or awards from an employer to an employee in recognition of some achievement in connection with his employment", 20/ with exceptions, for example, an award to an outstanding teacher, or to a government employee in recognition of his past accomplishments.

While the United States provides a statutory exemption for achievement awards generally, the exemption does not apply if the recipient must enter a contest and if he must render substantial services as a condition.

Deductibility of Prizes and Awards

The Department of National Revenue has indicated that as a matter of practice it will allow as a deduction any bona fide and reasonable payment made by an employer under an employee suggestion plan which is open generally to all his employees and which provides for awards for

suggestions leading to a better quality product, increased rate of output, improved methods of operation and the like. If the true nature of a payment under a suggestion award plan is ascertained to be a payment for the purchase of an asset from an employee, for example, an invention, it might not be deductible by reason of being a capital outlay. 21/ This exposition of departmental practice suggests that there may be some awards, for example, one granted to an employee where no plan exists, which would not be allowed as a deduction. It would seem, however, that there is nothing in section 12(1)(a) which would prevent a deduction for such an expenditure. Section 12(1)(b) rules out the deduction of expenditures on account of capital and section 12(2) provides safeguards in respect of the deductibility of otherwise deductible outlays or expenditures which are unreasonable in the circumstances.

REFERENCES

- 1/ 9 Tax A.B.C. (1955), 374; 54 DTC 17.
- 2/ 19 Tax A.B.C. (1958), 289; 58 DTC 336.
- 3/ 31 Tax A.B.C. (1963), 197; 63 DTC 210.
- 4/ 12 Tax A.B.C. (1955), 279; 55 DTC 157.
- 5/ 15 Tax A.B.C. (1956), 366; 56 DTC 393.
- 6/ 12 Tax A.B.C. (1955), 347; 55 DTC 204.
- 7/ Ibid., Tax A.B.C. 352; DTC 207.
- 8/ 15 Tax A.B.C. (1956), 335; 56 DTC 378.
- 9/ "Scholarships", 2 Canadian Tax Journal (1954), pp. 218-219.
- 10/ Internal Revenue Code, Section 151(e).
- 11/ Supra, pp. 73-4.
- 12/ [1965] C.T.C. 423; 65 DTC 5268.
- 13/ R.S.C. 1952, Chapter 116.
- 14/ [1965] C.T.C. at pp. 425-426; 65 DTC at p. 5270.
- 15/ 28 Tax A.B.C. (1962), 404; 62 DTC 134.
- 16/ 12 Tax A.B.C. (1955), 379; 55 DTC 227.
- 17/ [1966] C.T.C. 260; 66 DTC 5212.
- 18/ 21 Tax A.B.C. (1958), 145; 59 DTC 8.
- 19/ 24 Tax A.B.C. (1960), 133; 60 DTC 242.
- 20/ Regulation 1.74-1(b).
- 21/ Canadian Tax Reporter, Toronto: CCH Canadian Limited, para. 10-421.

CHAPTER 9

SOCIAL SECURITY PAYMENTS

A wide variety of transfer payments made by the federal, provincial and municipal governments of Canada form a cluster of social security benefits which receive disparate treatment under Canadian income tax law. The types of benefits considered below are: (1) workmen's compensation payments; (2) unemployment insurance payments; (3) family allowance payments; (4) old age security payments; (5) hospital insurance payments; (6) Canada pension plan payments; and (7) certain miscellaneous payments.

It may be noted in passing that the Government of Canada uses the income tax as an instrument to encourage "private social security" in the form of protection against economic difficulty occasioned by retirement, sickness, accident, unemployment and death, by permitting, for example, the deduction of contributions by employers and employees to a registered pension fund or plan, and by excluding from the income of an employee the benefit he derives from his employer's contributions to or under a registered pension fund or plan, group sickness or accident insurance plan, medical services plan, supplementary unemployment benefit plan, deferred profit-sharing plan or group term life insurance policy. These benefits are considered elsewhere, particularly in the discussion of fringe benefits in Chapter 3.

WORKMEN'S COMPENSATION BENEFITS

Provincial workmen's compensation legislation long antedates federal income taxation, the first workmen's compensation law having been enacted

in British Columbia in 1902. 1/ Provincial legislation recognizes the principle of compensation for workmen for industrial accidents and sickness as distinguished from the older idea of the employer's liability previously accepted in English and United States law. Under the statutes, employees are deprived of their right of action against their employers, and, in some provinces, such as Alberta, but not British Columbia, against third persons. The burden of financing the workmen's compensation benefits falls on employers, who are required to pay assessments in respect of each of their employees. The benefits available to employees and their families are of different kinds: (1) in the event of the death of a workman, payment of funeral expenses and periodic payments to his dependants; (2) compensation for the loss or loss of use of parts of the body; (3) compensation for loss of earnings; (4) the payment of medical and hospital bills; and (5) in some cases, compensation for disfigurement and for pain and suffering.

Resolution 13 of the Budget of 1942 provided:

That any amount received as compensation, other than compensation for loss of time, under any workmen's compensation legislation of any of the provinces of Canada in respect of any injury or disability incurred or in respect of any death, shall be exempt from taxation. 2/ [Emphasis added.]

This resolution was passed without discussion, apart from the following exchange:

Mr. Hanson (York-Sunbury): If a workman or any other person were to receive damages in an action at law, altogether outside the workmen's compensation legislation, would that be looked upon as income? I should not think so.

Mr. Ilesley: Generally speaking it is not regarded as income. 3/

When the resolution was enacted as an amendment to the Income War Tax Act,

the words "other than compensation for loss of time" were omitted. Section 4(u) provided for the exemption of "any amount received by any person as compensation under the Workmen's Compensation Act of any province of Canada or the Government Employees' Compensation Act in respect of any injury or disability incurred or in respect of any death". According to one commentator, this paragraph raised the question as to

...whether or not other sickness, accident or disability payments are by inference to be considered as taxable income. The practice of the Department, however, is to treat such receipts as exempt in the hands of the recipient.

In the absence of the provisions of this paragraph payments mentioned herein may, perhaps, be regarded as taxable as being "an annual profit or gain from any other source"; on the other hand a lump sum paid to dependents of a wage-earner on account of his death would seem to constitute a receipt of a capital nature. 4/

Another authority states that it was departmental practice of many years' standing prior to the enactment of section 4(u) to exempt payments received under workmen's compensation statutes. 5/

The counterpart of section 4(u) in the Income Tax Act is section 10(1)(g) which provides for the exemption of "compensation received under an employees' or workmen's compensation Act of Canada or a province in respect of an injury, disability or death". Since the contributions by employers for workmen's compensation purposes are presumably deducted by them as ordinary business expenses, the effect of section 10(1)(g) is to permit the payments to escape tax completely.

To the extent that the payments to an employee represent compensation for loss of wages due to accident or illness, their exemption from taxation is difficult to justify. Indeed, it would appear from Resolution 13 of

the 1942 Budget, supra, that compensation for loss of time was not intended to be exempt. Whether workmen's compensation payments for loss of wages would be taxable in the absence of section 10(1)(g) is difficult to say. Conceivably they might be regarded as income from an office or employment, and might also fall to be taxed as "income for the year from all sources" in section 3, although this omnibus clause has been given virtually no content by the courts.

The compensation payable for the loss or loss of use of a body member under early Canadian workmen's compensation laws was often set out in a schedule. For example, the Alberta Workmen's Compensation Act, 1918 6/ provided that "Where permanent partial disability results from the injury the total compensation shall be: (a) For the loss by separation of one arm at or above the elbow joint or the permanent or complete loss of the use of one arm, \$1,000; (b) For the loss by separation of one leg at or above the knee joint or the permanent or complete loss of the use of one leg, \$860; (c) For the loss by separation of one foot at or above the ankle or the permanent or complete loss of the use of one foot \$625", and so on. The exemption of such payments from taxation can be justified, not only on humanitarian grounds, but also by regarding the payment as compensation for the loss of part of the employee's capital equipment. However, the schedular system of compensation has long since been changed 7/ to the present-day formula according to which, roughly speaking, compensation is based on a percentage of the employee's wages. In Alberta, 8/ maximum compensation appears to be \$3,750 per annum (75 per cent of average weekly earnings up to \$5,000) for life in the case of permanent total disability which is defined to include such injuries as the loss of both eyes, both feet, both hands, or the loss of one hand and one foot. Thus, a welder

aged 25, and earning \$5,000 per annum, who loses both feet in an industrial accident, would receive, at present rates, \$3,750 a year for life or a total of over \$168,000 if he lived to age 70. 9/ The manifest inequity of exempting these payments from the tax base, when working taxpayers receiving remuneration in the same amount must pay tax on it, serves perhaps to reveal a major defect in the policy of seeking to mitigate personal misfortune through income tax relief.

Although workmen's compensation payments are exempt from the United States federal income tax, some state income tax laws include such benefits as income for tax purposes:

Of the 37 State personal income tax laws, only 13 explicitly exclude workmen's compensation benefits; some of the other States exclude by regulation. 10/

UNEMPLOYMENT INSURANCE

The Unemployment Insurance Act was passed by the Parliament of Canada in 1941 as a direct result of a recommendation of the Rowell-Sirois Commission. Coverage under this scheme has been gradually extended until the only major exclusions are workers in agriculture, members of the armed forces, certain civil servants, and salaried workers earning more than \$5,460 a year. Under the unemployment insurance plan, revenue comes from four sources: (a) contributions by insured persons; (b) contributions by employers of insured persons; (c) contributions by the federal government; and (d) interest earnings on the Unemployment Insurance Fund. The total employers' contributions equal the total employees' contributions, and the Government contributes an amount equal to one fifth of the combined employer-employee contributions and also bears the full cost of administration of

the plan. As regards the interest earnings, the Report of the Committee of Inquiry into the Unemployment Insurance Act, hereinafter referred to as the Gill Report, stated:

By reason of the rapid growth of the Fund, the investment income has been a much more important factor in revenues than was originally expected, rising to as much as 14 per cent of the ordinary revenue. Over the history of the Fund to March 31, 1961, interest has been about 8-1/2 per cent of the contribution revenue. This compares with the 2 per cent allowed originally. 11/

An insured person who meets certain basic conditions is entitled to draw benefits which vary with the rate of contribution, the length of employment in insured employment and family status.

Section 10(1)(h) of the Income Tax Act provides for the exemption of "benefits received under the Unemployment Insurance Act". No comparable provision was contained in the Income War Tax Act although it is understood that as a matter of departmental practice, unemployment insurance benefits were not taxed. This exemption is difficult to justify. If one taxpayer earns \$5,000 by working for 12 months, and another taxpayer receives \$5,000 consisting of \$4,000 earned over 6 months and \$1,000 from unemployment benefits, there seems to be no sound reason why the latter should pay less tax than the former. The case for taxation of unemployment insurance benefits is strengthened by the extension of coverage to seasonal workers, having regard to the following comments in the Gill Report:

Under the existing plan, benefit may be paid to seasonal workers during their off season, even though they have never worked in the off season and have no expectation of doing so. This is an income supplement rather than an insurance benefit. 12/

And further,

A plan based upon insurance principles should be required only to provide indemnity for loss. As already noted, it cannot be held that a person has lost wages during an idle period when his past work pattern shows that he had no expectation of working during that period. 13/

The simple expedient of taxing unemployment insurance benefits encounters a problem of double taxation. Contributions by an employee to the unemployment insurance fund are not deductible, so that to the extent that his benefits represent a return of his contributions, they are properly exempted from taxation as a return of capital. If benefits are regarded as made up in the same proportion as the Unemployment Insurance Fund (as discussed above) of employee contributions (38 per cent), employer contributions, (38 per cent), Government contributions (15 per cent, or one fifth of the combined employee-employer contributions), and interest earnings (8-1/2 per cent), the employee receives 62 per cent of his benefits tax free. The employer will, of course, have deducted his contributions as business expenses.

There are various ways in which unemployment insurance benefits might be taxed:

- (1) Employees would be permitted to deduct the contributions and would be taxed on the whole of their benefits. This is the simplest and perhaps the most desirable solution.
- (2) If employee contributions were not permitted to be deducted, a proportion of each benefit payment would be excluded as a recovery of the employee's contributions, perhaps pursuant to a formula similar to that used in the taxation of annuities, if one could

be devised, with the balance being taxed as income. This solution would be bound to add to the complexity of the income tax and to the burdens of compliance and administration.

- (3) If employee contributions were not permitted to be deducted, benefits could be excluded from income until the employee recovered his contributions, with subsequent payments being taxed in full.

As for the revenue implications of a tax on unemployment insurance benefits, for the fiscal year ending March 31, 1961, the sum of \$513,905,724.35 was paid in respect of 1,546,414 claims, or an average of \$332.32 per claim. 14/ However, without some knowledge of the marginal rate of tax on the recipients, it is not possible to estimate with any accuracy the additional revenue which would have been generated by the taxation of these benefits.

FAMILY ALLOWANCES AND YOUTH ALLOWANCES

Family allowances are paid by the Government of Canada pursuant to the provisions of the Family Allowances Act, which was passed in 1944. 15/ The statute provides for the payment out of the Consolidate Revenue Fund, in respect of each child resident in Canada maintained by a parent, the following monthly allowance: (1) six dollars for each child under 10 years of age; and (2) eight dollars for each child from 10 to 15 years of age. Similarly, under the recently enacted Youth Allowances Act, 16/ provision is made for the payment out of the Consolidated Revenue Fund of a monthly allowance of ten dollars to a parent, in respect of a dependent youth maintained by such parent. The term "dependent youth" is defined in section 2(c) to mean

a person resident in Canada who has attained the age of sixteen years and has not attained the age of eighteen years and

- (i) is in full-time attendance at a school or university, or
- (ii) is, by reason of any mental or physical infirmity, precluded from attending or attending on a full-time basis at a school or university.

Exemption from taxation of family allowances and youth allowances is expressly provided in section 7 of the Family Allowances Act and section 7 of the Youth Allowances Act, respectively.

With respect to family allowances, there is a countervailing tax consideration, namely, the reduced exemption for children qualified for family allowance, which, in the case of taxpayers with higher incomes, serves to nullify the benefit arising from the exclusion of these payments from the tax base. More specifically, paragraphs (c) and (d) of sub-section (1) of section 26 provide that the exemption for a dependent child is \$300 if the child is qualified for family allowance and \$550 if the child is not qualified. The expression "child qualified for family allowance" is defined in section 139(1)(f) to mean "a child who, in the last month of the taxation year in respect of which the expression is being applied, was or might have been qualified by registration under the Family Allowances Act, so that an allowance under the said Act was or might have been payable in respect of that child for the immediately following month". Hence, whether a child has in fact been registered or not, only the lower exemption is available.

A different method for preventing a taxpayer from enjoying the two-fold benefit of family allowance payments and income tax relief in respect of the same child was enacted in 1945 as section 4 of Paragraph A of the First Schedule to the Income War Tax Act, and provided that a taxpayer who was entitled to a tax credit

...on account of a child in respect of whom an allowance has been paid during the taxation year under The Family Allowances Act, 1944 shall...pay a tax in respect of each such child, in addition to the normal tax and the graduated tax, equal to a percentage of the allowances so paid determined in the following tables by reference to the income of the taxpayer in the taxation year and, in 1946 and subsequent taxation years, by reference to the number of dependents in respect of whom he is so entitled to a deduction. 17/

Thus, for the 1945 taxation year, a married taxpayer with income between \$1,200 and \$1,400 paid an additional tax equal to 10 per cent of the amount of the family allowances. The rates were graduated, and a taxpayer who enjoyed more than \$3,000 income paid a tax equal to 100 per cent of the amounts received as family allowances. And all this, in spite of the provisions of section 7 of the Family Allowances Act, 1944 which stated that "no allowance under this Act shall be subject to taxation...." The Acting Minister of Finance, the Honourable Douglas Abbott explained: "The family allowance recovery tables...were introduced as a temporary supplement to the present tax structure, to give effect to the principle approved by the House that the taxpayer should not benefit in full from both family allowance payments and relief for the same child granted under the income tax". 18/

In 1946, the First Schedule, including the above provision, was repealed, and the present scheme was enacted whereby a reduced exemption is granted to taxpayers in respect of children who were or might have been registered under the Family Allowances Act. 19/ The new scheme was objected to on the ground of the alleged compulsion on taxpayers to accept family allowances. Mr. Abbott explained that there was no compulsion, since taxpayers were not obliged to accept the family allowance payments although they would not be entitled to the larger exemption for children who were "qualified" for family allowances. He rejected the suggestion that taxpayers

be permitted a choice of either taking the family allowances or the larger deduction because of the administrative difficulties to which it would give rise both for the Department of National Revenue and especially for employers faced with the problem of withholding the correct amount of tax from their employees' remuneration. That Mr. Abbott's concern over the administrative difficulties was warranted is borne out in an article by J. H. Perry, "Mr. Wooley and the Income Tax System", 20/ where the author states: "While arbitrary, the plan now in effect eliminates a mountain of red tape and a sea of confusion that would be encountered under any other scheme", and then proceeds over the next two pages to give specific examples of the complexities which attend the optional scheme. He points out, too, that for the bulk of taxpayers, the present system (tax-free family allowances plus the lower exemption) is to their considerable financial advantage, and that for only a very few taxpayers (about 1 per cent) does the financial advantage lie in the higher exemption although, he says, to give all taxpayers the option in order to benefit these few well-to-do "might conceivably cost employers and the government more in administrative expense than the financial advantage these taxpayers would gain". 21/

If the optional scheme is impracticable, as it appears to be, the alternatives to the present system are:

- (1) As Mr. Perry suggests in his article, "...to retain the 'compulsory' system of family allowance payments but give the taxpayer the option of working out the cash value of a \$400 [now \$550] income deduction at his top marginal rate in filing his return. If this value exceeded the cash benefit he had received from his combined family allowance plus \$150 [now \$300] deduction he could be permitted to take a credit against his tax for the difference". 22/

- (2) To give the taxpayer the best of both worlds—tax-free family allowances, and no reduction in the exemption in respect of dependent children.
- (3) To tax family allowances, with no reduction in the exemption.

OLD AGE SECURITY PAYMENTS

The Old Age Security Act was enacted by Parliament in 1951, 23/ in order "to achieve for our aged people the ends of social justice". 24/ Until recently, that statute, as amended, provided for the payment to those aged 70 and over who met certain residence requirements of \$75 per month for life, irrespective of their need. In 1965 25/ the age at which the pension becomes payable was reduced to 65, effective in 1970. The transition from making payments at age 70 to making them at age 65 is to be effected gradually. That is to say, in 1966, the pension will be available to people who have reached age 69, in 1967 to people from age 68, in 1968 to people from age 67, in 1969 to people from age 66, and in 1970 to people from age 65.

Unlike family allowance and youth allowance payments, old age security payments are not financed out of the Consolidated Revenue Fund but rather by three earmarked taxes which, at the inception of the programme, were as follows: (a) 2 per cent tax on personal taxable income, with a maximum of \$60; (b) 2 per cent tax on corporate profits; and (c) 2 per cent (1/5th) of the 10 per cent manufacturer's sales tax. In 1959, the rates were raised to 3 per cent, with a maximum of \$90 in the case of the tax on personal taxable income. In 1963, the rate on personal taxable income was raised to 4 per cent with a maximum of \$120 so that the present formula is 4-3-3.

Old age security payments appear to be taxable under section 6(1)(a)(iv) of the Income Tax Act which requires the inclusion in income of "superannuation or pension benefits". These terms are defined in section 139(1)(ar) to include "any amount received out of or under a superannuation or pension fund or plan". The inclusion of these payments in income involves an element of double taxation, in that the contributions are included in the tax base at an earlier stage. There is, however, a mitigating factor in the form of a personal exemption of \$500 which, until 1965, was available to persons aged 65 and over without qualification. The exemption was enacted in 1948. The effect of amendments to the Income Tax Act in 1965 26/ is that for the 1970 and subsequent taxation years, the exemption will be allowed only if the taxpayer has attained the age of 70 years, and that for the taxation years 1966 to 1969 inclusive, a taxpayer who has attained the age of 65 years but has not attained the age of 70 years will be allowed the exemption only if he did not receive a pension under the Old Age Security Act in respect of any month in that year. Thus, for taxpayers aged 65 to 69, no relief from double taxation of their old age security payments is provided.

Repeal of the \$500 exemption has been recommended by a well-known Canadian fiscal authority:

As to the treatment of pensions under the income tax, every pensioner whose income is above a certain level must pay tax upon his universal pension since the latter is considered part of taxable income. The amount of pension taken back in tax is influenced by the scheme of exemptions, however, there being an additional Dominion exemption of \$500 from the taxable income of persons aged 65 and over. This exemption was introduced in the budget of May 1948, three and one-half years before the universal pension was adopted. A case can now be made for removing it since the universal pension of 1951 confers a second benefit, often on those who have little need of assistance. Just as the income tax serves as a means

tests [sic] for those who pay tax, so it can be made to serve as a partial means test for those who receive benefits. If the one is just and logical so is the other. 27/

If the \$500 exemption were repealed, an alternative solution to the double taxation problem, at least in so far as the recipients' contributions are concerned, might be to permit him to recover the value of his investment tax-free during the period of his average life expectancy. The compliance problem would, of course, be substantial if individuals were expected to make the computations themselves.

HOSPITAL INSURANCE

Private Medical Service Plans

Premiums paid by an employee for medical and hospital insurance are personal expenses, unconnected with his employment, and are not deductible for tax purposes. Premiums paid by an employer on behalf of an employee are deductible as a cost of the employer but are expressly excluded from the employee's income by section 5(1)(a), presumably to encourage employees to obtain protection against accident and sickness. The value of any hospital services received by an employee is not includible in his income, and may be taken into account in computing his medical expense deductions, whether or not the premiums were paid by the employee or by the employer on his behalf. Thus, employees whose medical services premiums are paid by their employers enjoy an advantage over employees who must pay their own way.

Government Hospital Insurance

All provincial governments and the governments of the Yukon and the Northwest Territories operate hospital insurance programmes, the costs of

which the federal government shares. The methods adopted by the provinces to finance hospital insurance vary. Three provinces, Ontario, Manitoba and Saskatchewan, require payment of a premium 28/ whereas the other provinces meet the cost out of other revenues. Premiums, or tax in lieu of premiums, paid by an employee are not deductible for income tax purposes. In those provinces which require the payment of premiums, employers sometimes pay a portion and in a few cases the whole of the premiums on behalf of their employees. A recent ruling 29/ by the Department of National Revenue requires that the portion of the premium paid by the employer be included in the employee's income as a taxable benefit. Two reasons have been advanced in support of this ruling. The primary reason, according to an official in the Department of National Revenue, is that the obligation of insured persons to pay premiums is a statutory liability. Hence, when an employer discharges that obligation by paying his employees' premiums, he is clearly conferring a benefit in the same way as if he had paid their income tax. On the other hand, the reasoning proceeds, premiums paid by an employer on behalf of an employee under a private plan may confer no benefit on the employee: the employer is not discharging a liability of the employee, and the latter may never fall ill so as to realize a benefit under the plan. This reasoning does not bear analysis, for the protection afforded by a private plan surely is a "benefit" within the ordinary acceptance of that word, and would appear to have been so regarded by Parliament when it enacted section 5(1)(a) which excludes from income "the benefit he derives from his employer's contributions to or under a...medical services plan...." Hence, the inclusion in the income of an employee of premiums paid by his employer under a government plan, but the continued exclusion from income of the premiums paid under a private plan, reveal an inconsistency in the law.

Another ground for the new rule is that to the extent that premiums paid by an employer on behalf of his employees were not included in the latter's income, there was discrimination against employees in other provinces where hospital insurance is financed from other tax revenues. Thus, an Ontario worker enjoyed a tax advantage over a Quebec worker who pays the provincial cost of hospital insurance from his wages in the form of sales tax. To resolve the difficulty by permitting employees in non-premium provinces to deduct some portion of their sales or other taxes in the computation of income is neither practicable nor desirable.

The correct portion would be virtually unascertainable and in any event the introduction of the principle of deducting provincial taxes from income for federal tax purposes would open a hornets' nest of confusion which experience in the U.S. would indicate should be avoided at almost any cost. The first round of deductibility of taxes is attractive, but the obvious result is simply an increase in rates on a smaller tax base. 30/

Payments made on behalf of the insured are not includible in his income. Unlike benefits received under a private plan, such payments are not includible in the computation of the employee's medical expense deductions for income tax purposes by reason of section 27(4a), the rationale for which appears to be that because the federal government is paying part of the hospital insurance costs, it does not wish to confer a double benefit on the taxpayer. This difference in tax treatment has prompted the allegation by certain labour leaders that the new ruling by the Department of National Revenue discriminates in favour of private pension plans:

Now the government wants it both ways: all money paid for provincial hospital insurance is taxable income but not all money spent on medical care is tax deductible. 31/

Private medical plans enjoy two advantages over government hospitalization plans: (1) premiums paid by employers on behalf of employees are excluded from the income of the latter; and (2) payments made on the insured's behalf are includible in the computation of his medical expense deductions. As for the first advantage, since a substantial measure of protection is now available to all residents of Canada under the compulsory government hospitalization plans, it does not seem inequitable to require those who enjoy the benefit of additional protection which is provided by their employers to include that benefit in their income. Equal tax treatment would thus be accorded those who pay the premiums themselves, for which they may not take a deduction, and those whose premiums are paid by their employers.

As for the second advantage (and alleged discrimination), one solution would be to permit a taxpayer to include in his medical expense deduction that proportion of the payments made on his behalf under a government plan which the province's share of cost (whether financed by premiums or other taxes) is of the total cost. That is to say, if the federal government paid 49 per cent of the costs, the employee could take into account in computing his medical expense deduction 51 per cent of the payments made on his behalf. The difficulty with this solution is that the federal contribution apparently varies from province to province. A simpler solution, of course, would be for Parliament to repeal section 27(4a) and permit payments made under government plans to be taken into account in the computation of the medical expense deduction.

CANADA PENSION PLAN

The purpose of the Canada Pension Plan 32/ "is to ensure that, as soon as is possible in a fair and practical way, all Canadians will be able

to retire in security and with dignity", and also "to make reasonable minimum levels of income available at normal retirement ages". 33/ The plan is to be financed by contributions from employees, employers and self-employed persons. 34/ No contributions are made on the first \$600 per annum of income. On earnings above \$600 and up to a ceiling which initially is \$5,000, the employee makes a contribution of 1.8 per cent of his salary or wages. The employer makes a matching contribution of 1.8 per cent on an employee's annual earnings between \$600 and \$5,000. This makes a total contribution from both employer and employee of 3.6 per cent. Self-employed people, from age 18 on, pay the combined rate for employees and employers, or 3.6 per cent, if their total earnings are \$800 a year or more. People in this category pay on annual earnings between \$600 and \$5,000. Thus, if a self-employed person earns \$3,600 a year, he will pay 3.6 per cent of \$3,000, or \$108 a year.

Unlike the taxes paid to finance the Old Age Security Act, contributions under the Canada Pension Plan are deductible for income tax purposes, 35/ as is the case with contributions to private pension plans. This feature has evoked the following comment:

The deductibility feature, designed presumably to equate it with private pension contributions, creates another anomaly in the area of health and social welfare contributions and payments. The deductibility of private pension contributions has purpose as an incentive for people to prepare themselves for retirement. Since the Canada Pension Plan is to be compulsory, the feature of deductibility hardly seems to fit the circumstances from the incentive standpoint.

At first glance, deductibility may appear consistent with the theory that since the receipts will be included in income the contribution should be deductible. This is consistent with the scheme for private plans, but inconsistent with the old age security scheme, where payments-in are not deductible but receipts are included in income. An individual's unemployment insurance contributions are not deductible, nor are his receipts included in income. 36/

Parliament is, of course, competent to bring the pension monies into tax twice: first, by denying a deduction in respect of the contributions, and secondly, by taxing the pension payments in the hands of the recipients. Such treatment, however, does seem harsh.

It would work to the advantage of the federal fisc if the employee were denied a deduction for his contributions during his working years, and was then permitted to deduct a portion of his pension payments as a return of contributions at a time when his income would presumably be much lower.

MISCELLANEOUS EXEMPTIONS

Section 10 of the Income Tax Act provides for the exemption of certain additional amounts in the nature of social security payments:

Section 10(1)(d). Service pension or allowance—"a pension payment or allowance that is received under or is subject to the Pension Act, the Civilian War Pensions and Allowances Act or the War Veterans' Allowance Act, or compensation received under regulations made under section 5 of the Aeronautics Act".

Section 10(1)(e). Service pension from another country—"a pension payment received on account of disability or death arising out of war service from a country that was an ally of His Majesty at the time of the war service, if that country grants substantially similar relief for the year to a person receiving a pension referred to in paragraph (d)".

Section 10(1)(f). Halifax disaster pensions—"a pension payment in respect of death or injury sustained in the explosion at Halifax in 1917 received from the Halifax Relief Commission the incorporation of which was confirmed by Chapter 24 of the Statutes of Canada, 1918".

Section 10(1)(ga). R.C.M.P. pension or compensation—"a pension payment or compensation received under section 22, 64, 78 or 112 of the Royal Canadian Mounted Police Act, in respect of an injury, disability or death".

With respect to service pensions or allowances, a commentator on a similar provision in the Income War Tax Act states:

War disability pensions were originally exempted from taxation under the original s. 4(1)(R.S.C. 1927, c. 97), but this paragraph was repealed by s. 3, c. 41, Statutes of 1932-33. For a period war disability pensions were taxed as income, presumably upon the theory that they are intended to make good assumed loss of earnings resulting through disability suffered in war service. Since 1942 war disability pensions have again been exempted from taxation under the new s. 4(1). 37/

The exemption of these payments serves to erode the tax base, probably not appreciably, and also makes for inequitable treatment of other taxpayers who do not happen to receive payments falling within any of these provisions.

APPRAISAL

That Canada's social security system is a fairly recent phenomenon is borne out by the fact that all of the above social security measures were enacted since the beginning of World War II, with the exception of workmen's compensation, which was introduced into Canada early in the twentieth century. The common purpose of these measures is to mitigate personal hardship, whether occasioned by disability, unemployment, sickness or old age. Various methods have been adopted to finance these schemes: the federal government alone assumes responsibility for the payment of family allowances; workmen's compensation payments are paid from contributions made by employers; the Canada pension plan is financed by contributions by both employers and employees (as well as self-employed persons); and in the case

of unemployment insurance, all three parties—employers, employees and the government—provide funds. Nor is there any uniformity in the tax treatment of these schemes: (1) workmen's compensation payments are not taxed to the recipient even though he has made no contribution toward them; the employer will have deducted his contribution, so that the funds are never taxed; (2) unemployment insurance payments are not taxed to the recipient who, although not permitted to deduct his contribution, receives tax-free the contributions of his employer, the government and the earnings of the Unemployment Insurance Fund; (3) old age security payments are taxed to the recipient, who is not entitled to deduct his contribution, although the Income Tax Act provides for an exemption of \$500 for taxpayers 70 years of age and over; the portion of the payments made up of the corporate tax and the sales tax are taxed again in the hands of the recipient; (4) family allowances are not taxed to the recipient, who makes no direct contribution toward them, but a lower personal exemption is provided for children qualified for family allowances; (5) in the case of hospital insurance, no deduction is permitted for premiums or for tax in lieu thereof; the benefits are not includible in income, nor do they enter into the computation of the medical expense deduction; (6) Canada pension plan payments are taxable to the recipient, who will be able to deduct his contribution, as will his employer.

The high purpose of these social security measures—to provide relief for those suffering economic hardship—justifies the existence, but not the exclusion from income, of payments of workmen's compensation, R.M.C.P. compensation, unemployment insurance, veterans' pensions, or even family allowances. The exclusion of such payments results in manifest inequities in circumstances where the same total income is enjoyed by two taxpayers,

one of whom receives a portion of his in the form of unemployment insurance or workmen's compensation, even though these sums enhance his ability to pay and augment his command over society's scarce resources to the same extent as payments of salary and wages. To this extent, the Income Tax Act is not neutral or "source blind". Moreover, these exemptions serve to diminish or break down the progressiveness of the tax rate structure, for the higher the tax rate, the more the exclusion is worth. With respect to the amounts exempted by section 10, it is important to observe that not only are these amounts excluded from taxation, they are not to be regarded as "income" of the recipient for any purpose of the Act or Regulations, and hence would not be taken into account in determining a dependant's income for purposes of section 26 and Part X of the Regulations. In this respect, it is perhaps worth noting the following observation from the Gill Report: "The principal classes of alleged abuse that were drawn to our attention in representations made to us, apart from the question of payment of benefit to seasonal workers during their off season..., related to (a) the drawing of benefit by married women who are not in fact seeking employment...." 38/

While one may experience a visceral reaction against the taxation of payments intended to alleviate economic hardship occasioned by disability, accident, sickness or unemployment, it is true, nevertheless, that the community has established exemption levels—the "means test" of the income tax as they have been termed—so that amounts received in excess of these levels, whether in the form of salary or social security payments should receive equal tax treatment. It may well be that existing benefits under our various social security measures are not equal to their tasks; and it may also be true that existing exemption levels do not exclude amounts necessary to maintain a minimum standard of living in Canada. The

solution to these problems, if they exist, would seem to be to upgrade the benefit programmes and increase the exemptions, rather than to seek to promote the well-being of a few by carving out of the tax base exemptions which are worth more to taxpayers with higher incomes than they are to those truly in need.

One general scheme for the tax treatment of social security payments that would appear to do equity would be to permit the deduction of contributions under the various plans and to tax the benefits. On the other hand, since the deductions would be taken during the taxpayer's working years, when his income level would be high, it would doubtless be more satisfactory from the Crown's point of view to permit no deduction of the premiums and to tax the proceeds, from which the amount of the premiums could be recovered.

REFERENCES

- 1/ For a discussion of the early history of workmen's compensation legislation in Canada see U.S. Bureau of Labour Statistics, Workmen's Compensation Legislation of the United States and Canada, by L. D. Clark and M. C. Frincke, Jr., Washington: Government Printing Office, 1921, at p. 257.
- 2/ House of Commons Debates, 1942, vol. 5, p. 4478.
- 3/ Ibid.
- 4/ H.A.W. Plaxton, The Law Relating to Income Tax and Excess Profits Tax of the Dominion of Canada, 2nd ed., 1947, Toronto: The Carswell Company Limited, p. 92.
- 5/ Canada Tax Service, Toronto: Richard DeBoo Limited, pp. 10-161.
- 6/ S. A. 1918, Chapter 5, section 52.
- 7/ In Alberta, the change was legislated in 1921.
- 8/ R.S.A. 1955, Chapter 370, section 45, as amended by S.A. 1961, Chapter 89.
- 9/ Executives have been urged to avail themselves of the benefits available under workmen's compensation legislation: "In all provinces, except in Quebec, it is optional for employees in non-industrial firms to be covered. The annual cost is very low and the benefits on death or on permanent disability are substantial—for example, \$75 per month to the widow until death or remarriage. Best of all, these benefits are free, both of income tax and succession duties". L. E. Coward, "Tax Planning for the Executive", Report of the 11th Annual Tax Conference, Canadian Tax Foundation, 1957, 162 at p. 165.
- 10/ R. Muntz, "Social Security and the Personal Income Tax", 1 Tax Revision Compendium (1959), 353 at p. 354, n. 3.
- 11/ Ottawa: Queen's Printer, p. 65, para. 44.
- 12/ Ibid., p. 105, para. 9.
- 13/ Ibid., p. 131, para. 94.
- 14/ Unemployment Insurance Commission, 20th Annual Report, fiscal year ending March 31, 1961, pp. 25-27.
- 15/ The Act is now found in R.S.C., 1952, Chapter 109.
- 16/ S.C. 1964-65, Chapter 23.
- 17/ S.C. 1945, Chapter 23, section 9.

- 18/ House of Commons Debates, 1946, vol. 4, p. 3767.
- 19/ S.C. 1946, Chapter 55, section 4.
- 20/ 5 Canadian Tax Journal (1957), 20.
- 21/ Ibid., p. 22.
- 22/ Ibid., p. 22.
- 23/ S.C. 1951, Chapter 18.
- 24/ Report of the Joint Committee of the Senate and the House of Commons on Old Age Security, presented on June 28th, 1950.
- 25/ S.C. 1964-65, Chapter 51, section 119 ff.
- 26/ S.C. 1965, Chapter 18, section 6(3), amending para. (e) of section 26(1), and adding para. (f).
- 27/ D. C. MacGregor, "Further Thoughts on Tax Levels and Prospective Welfare Expenditures", 4 Canadian Tax Journal (1956), 171 at p. 176.
- 28/ The payment of premiums was required under the Prince Edward Island scheme until December 1, 1962, when an alternative method of financing was adopted.
- 29/ Information Bulletin No. 25, issued June 8, 1964.
- 30/ "Fact and Opinion", 13 Canadian Tax Journal (1964), 145 at p. 147.
- 31/ Murray Cotterill, public relations director of the United Steel Workers, as reported in the Financial Times of Canada, June 8, 1964, at p. 11.
- 32/ S.C. 1964-65, Chapter 51.
- 33/ White Paper, Canada Pension Plan, House of Commons Debates, vol. 2, March 17, 1964, p. 1197.
- 34/ See sections 8-19 of the Act and the succinct statement of the method of financing the Plan in Canada Pension Plan Guide, Toronto: CCH Canadian Limited, para. 500.
- 35/ Section 11(1)(x) of the Income Tax Act.
- 36/ "Fact and Opinion", 13 Canadian Tax Journal (1964), 145 at p. 146.
- 37/ H.A.W. Plaxton, The Law Relating to Income Tax and Excess Profits Tax of the Dominion of Canada, 2nd ed., 1947, Toronto: The Carswell Company Limited, p. 89., p. 133, para. 104.
- 38/ Report of the Committee of Inquiry into the Unemployment Insurance Act, Ottawa: Queen's Printer, 1962, p. 133, para. 104.

